THE BUSINESS QUARTERLY

VOLUME XVI
Number 2

SUMMER
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Who's Who in This Issue

What Do High School Students Know About Business? — *John J. Wettlaufer*

Common Stocks As Long-Term Investments — *Erle A. Steiss*

Creative Leadership in a Middle-Class Society — *George W. Goth*

How Some Companies Are Handling Salesmen's Car Expenses — *James D. McKnight*

Any Organization Can Survive Its Key Men — *J. Lyone Heppner*

Should Businessmen Utilize Theory in Pricing? — *Douglas H. MacAllan*

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THE BUSINESS QUARTERLY

VOLUME XVI NUMBER 2

SUMMER 1951

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WHO'S WHO IN THIS ISSUE

JOHN J. WETTLAUFER

Mr. Wettlaufer is an instructor in the School of Business Administration, University of Western Ontario. A graduate of Western in Business, he last spring completed the requirements for the M.B.A. degree. The article, "What Do High School Students Know About Business?" was specially adapted for *The Quarterly* from his Master's thesis. The entire survey was organized in three sections, viz.:

Part I: Results of the First Questionnaire Are Discouraging.

Part II: Testing the Socio-Economic Plant Tour as a Teaching Medium.

Part III: The Socio-Economic Plant Tour Endorsed by the Findings of the Second Survey.

EARLE A. STEISS

Mr. Steiss is Manager of the Investment Department at the Canada Trust Company and Huron & Erie Mortgage Corporation. After graduating from the University of Toronto and the Harvard Graduate School of Business Administration he was Instructor in Accounting on the Harvard staff for two years. Thereafter he became associated with one of the largest investment trusts in Canada as Assistant to the President. For the past two years Mr. Steiss has been a part-time lecturer in Finance in the School of Business Administration at Western. His article on common stocks, one of a number which he has contributed to *The Quarterly,* is the transcript of a talk which was originally given to the Kiwanis Club of Sarnia May 22nd, 1951.

GEORGE W. GOTH

Rev. Goth is minister of Metropolitan United Church, London. Born in Ottawa and graduated from McGill University and Union

Theological Seminary, he preached in Quebec and Manitoba before coming to Ontario. In his own words, Rev. Goth's main concern in the ministry is to "make Christianity relevant for the whole of life" — a concern which he forcefully demonstrates in his contribution to this issue of *The Quarterly.*

JAMES D. McKNIGHT

Mr. McKnight is a 1951 graduate of the School of Business Administration, University of Western Ontario. His survey of the administration of salesmen's cars was conducted in his capacity as research assistant in the School's Division of Resarch. Mr. McKnight is presently employed with International Business Machines Limited in Toronto.

J. LYONE HEPPNER

Mr. Heppner is a District Manager in Montreal for the Confederation Life Association. Educated at the University of Manitoba and the University of London, England, he has had merchandising and administrative experience in England, the United States and Canada. Mr. Heppner has been a consultant on point-of-sales merchandising for several large Canadian sales organizations, and was formerly Sales Manager and assistant to the Vice-President of General Products Manufacturing Corporation.

DOUGLAS H. MacALLAN

Mr. MacAllan was recently associated with Imperial Oil Limited in Toronto. Graduating last spring from the School of Business at Western, Mr. MacAllan found a particular interest in a study of some aspects of economic price theory and their relationships to pricing policy—the theme of his *Quarterly* article.

THE
BUSINESS QUARTERLY

What Do High School Students Know About Business?

John J. Wettlaufer

The attitudes and opinions of the students of today will set the atmosphere in which business must operate tomorrow. The great majority of students will go to work upon completion of their high school studies. They will be employed in a business system of which they have learned very little. They will take their place as citizens of the community with little knowledge of the contribution that business makes to that community—the provision of jobs, income, and general welfare.

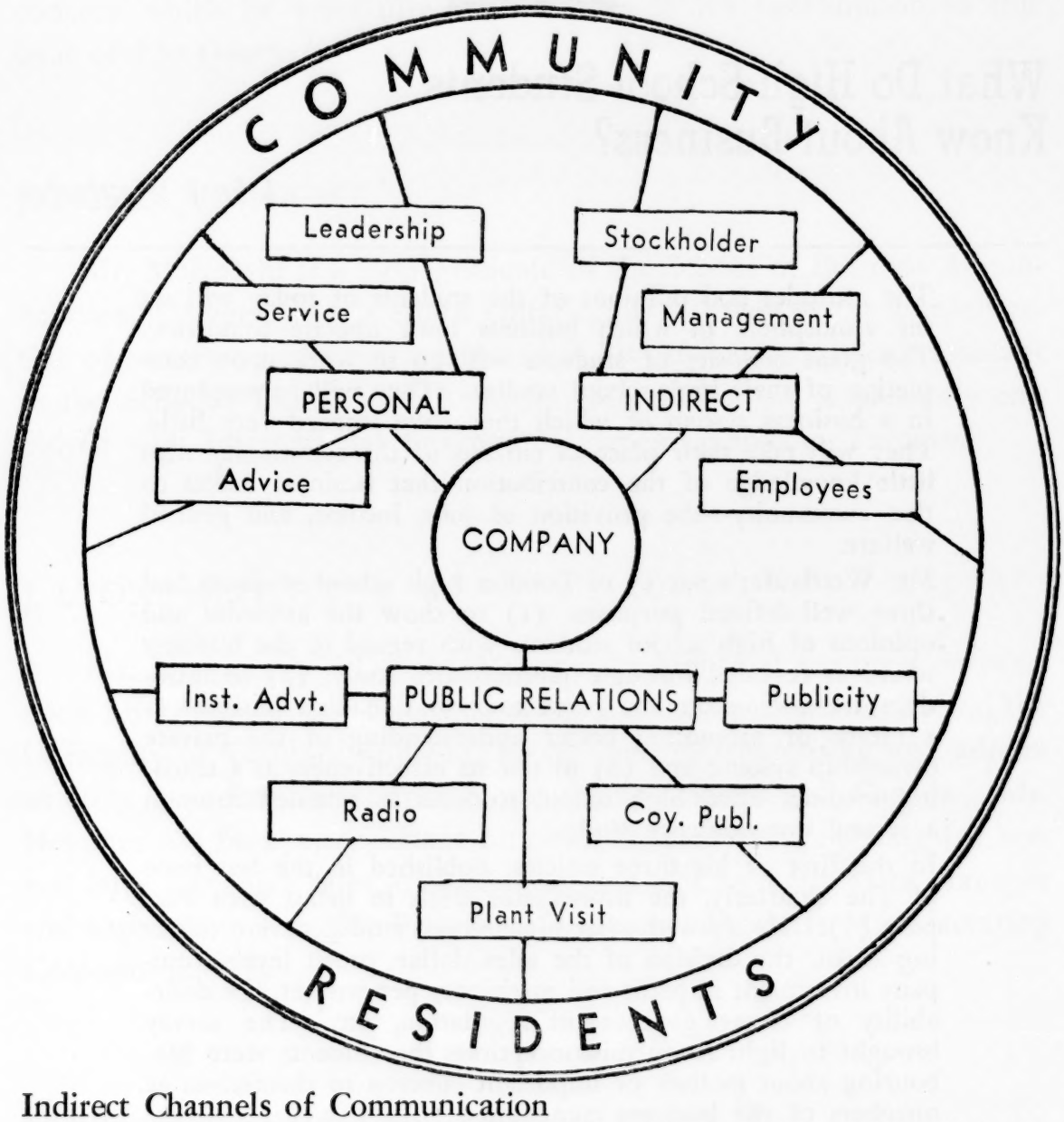
Mr. Wettlaufer's survey of London high school students had three well-defined purposes: (1) to show the attitudes and opinions of high school students with regard to the business world as revealed through questionnaire study; (2) to introduce the socio-economic plant tour to Canadian business as a means of promoting better understanding of the private ownership system; and (3) to test its effectiveness as a teaching medium upon high school students as revealed through a second questionnaire study.

In the first of his three articles, published in the last issue of The Quarterly, the investigator dealt in detail with Purpose (1). He showed what high school students were thinking about: the division of the sales dollar, profit levels, company investment in plant and machinery per worker, the desirability of closer government regulation, etc. The survey brought to light many misconceptions the students were harbouring about matters of important concern to themselves as members of the business community.

Now in Part II Mr. Wettlaufer continues with a brief examination of the main channels of communication between business and the community, with special emphasis on the socio-economic plant tour. He goes on to describe the planning and implementing of the visits of a group of London high school students to two contrasting plants: McCormick's Limited and General Motors Diesel Limited.

HOW DOES the general public obtain its information concerning the workings of any particular company? The following exhibit is an attempt to chart some of the principal flows of information from a company to the residents of a community. These channels fall into three main classifications: (1) indirect; (2) personal; and (3) public relations.

CHANNELS OF COMMUNICATION



Indirect Channels of Communication

This refers to the flow of information through the media of stockholders, (the owners of the business), management people, and employees. Some companies have made splendid use of this medium. Stockholder relations are important and can be a real influence in a community. Management people operate the business and as a group should be able to translate company policies in terms of community benefits. The most important group, however, are the people that work

in the company—the employees. What they think about the company will be essentially what the community thinks. The major problem is that many people in *all* of these groups neither know nor understand company policies. Thus we have economic misunderstanding filtering out into the community.

Personal Channels of Communication

Here we mean the participation of top management people in the life of the community.

> "The truth is that Americans are just about as busy with their non-official, unremunerated, voluntary activities as they are with their official duties; and these unpaid, unofficial, off-duty activities have a deeper and more lasting effect upon American life, and even American policies, than do the official ones.[1]

This quotation applies as aptly to the Canadian businessman as it does to the American.

Civic participation seems to fall into three categories: (1) leadership, (2) service, and (3) advice.

Leadership

Businessmen have always taken a leading role in the community. If individuals are needed to head up a Red Cross campaign or to initiate a fund drive, management people seem to get the assignment because they have the ability and energy to do the job well.

Service

If management people were to withdraw from the numerous service clubs that work in our community, they would leave a tremendous gap. For years business has made a willing and cheerful contribution to the fine work of these organizations.

Advice

There are very few advisory boards that do not have a business representative. Whether it be a university, in a church, or in counselling a high school student, top executives are doing their part to build a better community.

While these activities represent a significant function of business and assist in building better community-business relationships, they do very little to help the public understand the "how" and "why" of a business enterprise.

Public Relations

More direct channels of communication are indicated here in that the company has some control over the kind of information that is given, as well as over the medium that is used. In a broad sense, public relations crosses all channels and uses all media, but only those most commonly used as management tools will be considered.

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[1] "The Busy, Busy Citizen", *Fortune,* February, 1950, p. 96.

Institutional Advertising

Many companies have been using this medium which conveys its ideas through the printed word, as a means of establishing new attitudes. The public relations aspect tries to develop a friendly community spirit, while the public service function endeavours to exert strong leadership in public affairs. During the past year, the promotion of our private enterprise system has taken a large portion of the institutional advertising budget. How effective this campaign, "Main Street is Freedom Street", has been is open to question, but it certainly has the support of many leading industrialists.

Publicity

At one time publicity was public relations, but today it is only one part of a large field.

> "Publicity work boils down to a matter of analyzing the vast store of human interest and news material that is inherent in any organization of human beings, selecting a portion of it, dressing it up properly, and making it available to media of information."[2]

People still associate the term "press agentry" with publicity, but the fact remains that business must not only do a good job, but it must let people know about it. Publicity makes use of both the printed and the spoken word.

Radio

The spoken word is often more effective than the printed word; therefore radio is a useful medium for public relations. Spot announcements as well as full programs have been used to good advantage.

Company Publications

There is some type of publication in every company, but the number and kind vary a great deal between plants. Some organizations are content with a mimeographed news bulletin, whereas others set up elaborate programs including a general corporation magazine, a local plant paper, news letters, educational pamphlets, as well as special edition of the annual report of the company. The annual report has particular value in that it gives insight into the economics of the company, especially when it uses a graphic presentation for easier understanding.

Plant Visits

Here is an ideal medium for community-business communication. By demonstration through the use of all five senses, this medium arouses interest and strengthens impressions. Plant visits range in scope from small guided tours to huge "open houses". For the most part, plant tours have been technological—stressing good working conditions and creating goodwill. Over the last three years, experiments have been made in the United States with a new type of plant tour. The techno-

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[2]Baus, Herbert M., "How to Get Publicity." *Public Relations Handbook* edited by Philip Lesly, New York: Prentice-Hall Inc., 1950, p. 450.

logical approach is used as a vehicle telling the story of the social and economic side of business. This new concept in plant tours has been named the "socio-economic" or "interpretive" plant tour.

The Socio-Economic Plant Tour

This new tour has been tried and approved by many leading industries: General Foods Corporation, Johns Mansville Corporation, Aluminum Company of America, Caterpillar Tractor Company and the Pittsburgh Plate Glass Company. The most comprehensive study of this new idea in plant tours has been made by the Opinion Research Corporation of Princeton, New Jersey. This company published a confidential report, "Plant Tours on a New Pattern", following two years of research with the help of fourteen major corporations.

Objectives

The objectives of the new-type tour are basically the same as for any plant tour, i.e. (1) to give the visitor an understanding of the company's operations, its mechanical processes and its products; (2) to prove that the plant has safe and pleasant working conditions; and (3) to stimulate goodwill. However, the new pattern is intended to *add economic understanding*—to attempt to show what the plant means to the visitor and to the community.

Techniques

The socio-economic plant tour is made effective by the selection of a few economic facts and the repetition of these themes in many different ways. Visual and dramatic aids are employed as well as interpretation by guides and top management people.

The success of the interpretive tour depends first upon the enthusiastic support of all the principals, including the head of the company. Planning conferences are held to select the economic facts that are to be emphasized. A script is developed to bring out these points by relating them to specific things in the plant. Thus a guide will "interpret" a machine as an investment of stockholder capital.

Repetition is important if a thought or idea is to be retained for any length of time; e.g., the concept of productivity is brought out during a speech by the president; a guide shows how a machine can mean more production, cheaper product, more sales, more jobs; a demonstration contrasts old-fashioned hand methods with modern machinery; and display material tells the story in another way.

Visual and dramatic aids help to make the tour more effective. Display signs act as signals to the guides as well as conveying a message to the visitors. Price tags showing replacement cost of machinery are startling proof that it takes a lot of money to make a job. Highlight of any socio-economic tour is the dramatic presentation of the sales dollar breakdown. Many clever ideas may be used to demonstrate the

division of the dollar; e.g., electric display signs with coloured lights and tubes of varying lengths; a miniature train that dumps pennies into glass dishes, where they can be recounted for emphasis. Some companies recommend tying the demonstration to the company product; e.g., if you sell bologna, cut it into the correct proportion to the dollar breakdown; if you operate a dairy, let a quart of milk be your dollar and divide it into several glasses. Other ideas include sign boards, pie charts and bar charts.

Summary

The socio-economic plant tour seems to be the most effective channel of communication between a company and the community. It appears to be particularly suitable for students since it makes use of all five senses—sight, hearing, smell, touch and taste. The plant tour places the student in an atmosphere of business and gives him an opportunity to develop a "feel" for the industry. It represents one of the few channels of communication in which a presentation can be controlled and its effectiveness tested.

Introducing the Socio-Economic Plant Tour to Canadian Business

So far it has been demonstrated theoretically that the interpretive plant tour has value as a teaching medium. It remains to relate how such a tour was actually carried out, what its impact was upon Canadian business, and how far it was successful in promoting a better understanding of the private ownership system on the part of high school students.

The title, "Dollars at Work", seemed to fit the type of program that was being developed for students of London's high schools. Under this scheme, the tour pattern for each plant was drawn together, giving continuity to the project.

The General Plan

In order to give the student a representative picture of industry, much care was exercised in the selection of plants. The general plan included a Canadian subsidiary of a large Canadian corporation; a Canadian subsidiary of a large American corporation, and a small family-owned corporation. The three plants were to represent a cross-section of industry with as much contrast and as little overlap as possible.

McCormick's Limited, a subsidiary of Geo. Weston Limited, has been established in London since 1858. A light industry, it manufactures quality biscuits and confectionery. Since it had its beginning in the kitchen of the McCormick home in London this company typifies individual enterprise. The old terra cotta building with its step-worn floors is in striking contrast to the glamorous new plant of General Motors Diesel, a subsidiary of the largest corporation in the world, General Motors. The diesel plant is only a year old and was included

in the tour to give the students an opportunity to see how an industry gets a start. Again in contrast to McCormick's, General Motors Diesel is a heavy industry, manufacturing locomotives. It was planned to complete the picture with a visit to a family-owned corporation, Scott and McHale Limited. This shoe company is unique in many ways and it was felt that the students would be interested in its profit-sharing plan. Unfortunately, the whole program was delayed until the latter part of February and in the resulting conflict of time and unforseen circumstances, Scott and McHale Limited was forced to withdraw.[3]

The Sample

The total universe consisted of four hundred students which, for experimental purposes,, was too unwieldly. A sample group of fifty to one hundred students was considered ideal for plant tours. The results obtained from a representative group of this number are essentially as trustworthy as those obtained from the whole universe.

In tabulating the first questionnaire, a breakdown of the universe was made by individual schools and by class sections within each school. This permitted the withdrawal of whole classes rather than a few students from all classes. Key questions were used to select the sample. A combination of Beck Collegiate (Grades 12B and 12C) and Beal Technical School (Grade T 12 B) seemed to constitute a representative sample. Verification of the sample was obtained by additional check questions on profit per cents and investment per worker.

Another problem involved the students in the sample. In granting permission for the project, the Protestant Board of Education asked that the tours be held during the Easter vacation. This request applied specifically to the academic schools—Beck, Central and South. The Beal Technical School and Catholic Central agreed to participate at any time convenient to the industries.

Although 98 per cent of the respondents had indicated that they would like to tour some plants, there was no evidence that they would do it on their own time during the Easter vacation period. After the project was explained to them, however, over 84 per cent signed up for the two tours. Many students were unable to go because of commitments re jobs and holiday trips.

A number of people expressed doubt that the group would attend during the vacation period. Investigation later indicated that every student attended the first tour and only one missed the second trip. Some students sacrificed an afternoon's pay by leaving a part-time job to be present for the tour. As it happened, the students were required to give up only one holiday afternoon as the General Motors tour had to be postponed for two weeks.

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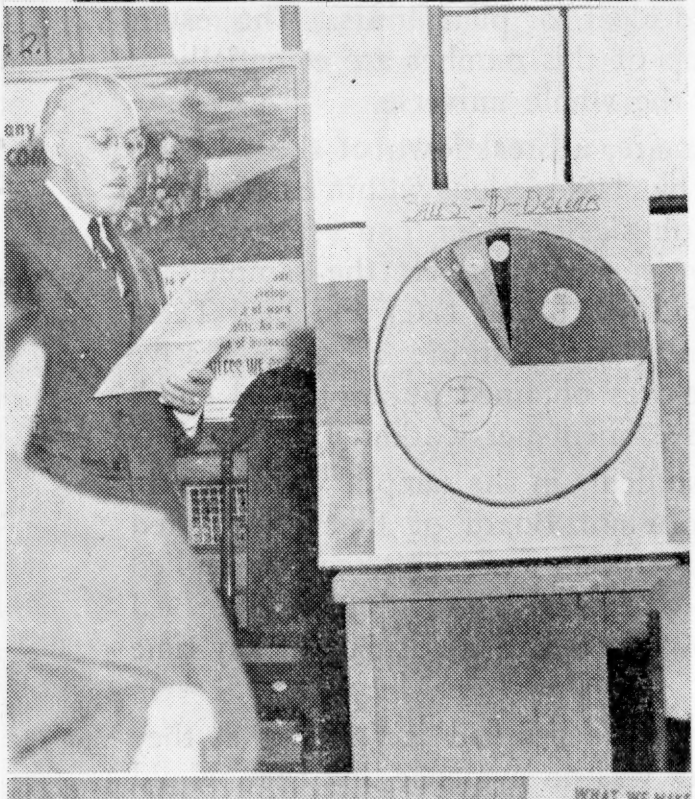
[3]Mr. J. McHale, Sr., President of Scott and McHale Limited, was one of the first London businessmen to give enthusiastic support to this project.



The McCormick's Limited Tour

The original program for McCormick's was initiated in December, 1950, at a meeting with Mr. Ray Batson, the General Manager, Mr. Brown, the Secretary-Treasurer, and Mr. H. Monck, the Personnel Officer. The committee gave assurance of full co-operation, which is essential to any socio-economic plant tour.

The Objectives

In consultation with the management group named above, the following objectives were set down: (1) to acquaint the students with the plant operation; (2) to convince them that McCormick's is a good place to work; (3) to increase their economic understanding. In this connection, McCormick's singled out the following ideas for special attention: (a) McCormick's make products, jobs and income for the community; (b) the use of modern machinery has increased the number of jobs and lowered the price of the company product; (c) the division of the company sales dollar is fair; and (d) it takes a lot of money to make a job.

Planning the Tour

Preliminary planning conferences were held over a period of two months during which the fullest co-operation was given by the McCormick people. After the themes had been selected, a tour

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McCORMICK'S DOLLAR AT WORK

1. Guide demonstrates to group.
2. Office manager, Mr. F. A. Douglas, gives dollar breakdown.
3. Mr. H. Simpson, Asst. General Manager, leads classroom presentation.

All photo credits—Mr. Bob Mann, U.W.O. Gazette photographer.

was made of the plant to determine the machinery and operations that were to serve as key points in the preparation of the scripts and display signs. After each meeting, a brief report was prepared and sent out in the form of a bulletin so that the company should have a complete summary of the progress due to date.

Mimeographed History

In order to prepare the students for their visit, a brief history of the company and an outline of its operations was mimeographed and made into booklet form along with some photographs of equipment. An envelope, containing the booklet and a letter setting out details of the tour, was given to each student a few days before the tour. The purpose of this material was to create a favourable impression and to conserve time during the tour by providing a background of the McCormick operation.

Display Materials

A study of plant operations indicated that there were wonderful opportunities to show the students that it costs a lot of money to make a job. For example, one Baker Perkins oven had a replacement cost of $125,000.00. Eight signs were prepared to bring out the replacement cost of machinery as an investment in stockholder dollars. All signs carried the theme, "Dollars at Work", as well as the notation, "Average Amount Invested per Employee—$4500.00". One poster was prepared to point out that McCormick's make jobs and income for the community as well as biscuits and confectionery. In addition, use was made of some display material that the company had on hand for their employees entitled, "You can't have unless you give". The material, which was brightly coloured and easy to read, helped to dramatize the financial facts and tie in the theme, "Dollars at Work".

Preparation of Scripts

Following selection of the themes and preparation of the display material, scripts were developed to bind the program together. There were three basic types of scripts. One was prepared as an addition to the chairmen's welcome. In pointing out that McCormick's is a subsidiary company, this script says:

> "Remember this is only our London plant! McCormick's is a subsidiary of George Weston Limited, a Canadian corporation which has other plants from coast to coast in Canada and six in the United States."

Later the script emphasizes the management function:

> "An industrial plant doesn't just happen—it doesn't grow like a tree. Management is responsible and yet management is more misunderstood than almost anything else in industry. As you know, it is management that must bring together the capital with which to buy the land, plant, equipment and machinery needed to create a job."

The scripts prepared for the sales dollar presentation will be discussed under that heading. The third type of script was used by the guides as an aid to "interpreting" during the tour. For example, a guide illustrated the problem of depreciation by reference to a chocolate enrobing machine.

> "By now, all of you realize that it takes a lot of capital to make a job. Besides the money needed to get the business rolling, additional funds are required to take care of improvements, developments and added cost of replacement equipment. This is a situation that has arisen from inflation. For instance, take this *chocolate enrober* that cost $20,000. Since it will be worn out in ten years, management sets aside $2000 each year so that at the end of the ten year period, $20,000 will be available to buy a new enrober, BUT the new enrober now costs $30,000 because of higher costs, which means an extra $10,000 must be obtained from re-invested profits or from additional stockholder capital."

All scripts were developed after consultation with the people who were going to use them. They were intended as an outline rather than an actual speech.

Sales Dollar Presentation

A major feature of our economic educational program was the "profit story". A pie chart with removable segments was selected as being the most effective display. The chart was operated in conjunction with the script. The segment representing *Raw Materials* was removed and the script came into play.

> "The first thing we need is the raw materials that go into the manufacture of biscuits and confectionery. Flour, sugar, shortening, chocolate are very expensive, but absolutely essential. We have plenty of operating costs such as freight, supplies and services. All of these materials and services cost us 66.5 cents which is two-thirds of our sales dollar."

The parent company, George Weston Limited, published a colourful and informative annual report giving the sales dollar breakdown in graphic form. A copy of this report was handed to each student at the conclusion of the tour.

The Plant Tour

The socio-economic plant tour for McCormick's was held on March 29, 1951. The students assembled in the main lobby and were taken up to the Board Room, which had been fitted up as a classroom. The program followed the outline set down in the tour pattern. Following the conference, the students were introduced to the guides, all of whom were in the supervisory level. The tour of operations was made in groups of ten, with the students sampling economic learning and McCormick hospitality at the same time. The final session, like the first, was held in the Board Room. During all the sessions, the students were most attentive and did not hesitate to ask questions during the period allotted to them.

The General Motors Diesel Tour

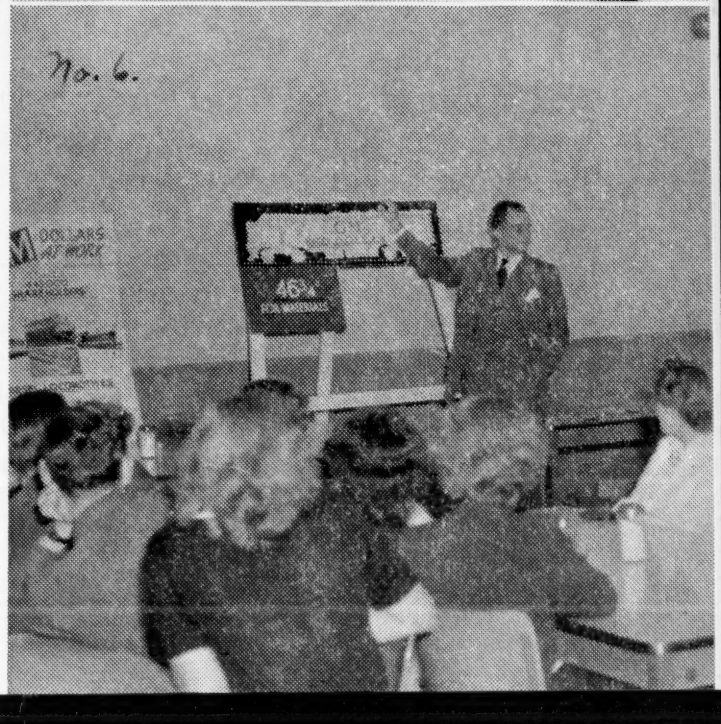
Mr. E. V. Rippingille, President of General Motors Diesel Limited, gave his whole-hearted support to the proposed plans for a socio-economic tour of his plant. The whole project was discussed in a meeting with Mr. W. Warner, Executive Assistant to the President, and Mr. E. Kelleher, the Director of Public Relations.

The Objectives

The planning conference selected these economic facts as the ones General Motors Diesel could demonstrate to advantage: (1) General Motors Diesel makes locomotives, jobs and income for the community; (2) it takes a lot of capital to make a job; (3) capital investment provides job security and lightens the job load; (4) the company serves three main groups of people — stockholders, employees and consumers; (5) the division of the company sales dollar is fair; and (6) General Motors Diesel is a good place to work.

Planning the Tour

The preliminary plans for both tours were very much alike. While in McCormick's the emphasis was on productivity ,in General Motors Diesel, the emphasis was placed on the large amount of capital needed to create a job, as well as the "risk-taking which is a part of our pri-



DRAMATIC PRESENTATION AT G.M. DIESEL

4. Sign emphasizes dollar investment.
5. Mr. E. V. Rippingille, Jr., President of General Motors Diesel Limited, opens classroom discussion.
6. Executive Assistant to the President, Mr. W. M. Warner, demonstrates what happens to the company sales dollar.

vate enterprise system. Mr. Kelleher had sat in on the McCormick tour to see what improvements, if any, could be made. His only suggestion was to make the groups smaller. One guide was used for every five students on the General Motors Diesel tour—a helpful change in view of the noise problem attendant in any heavy industry.

Mimeographed History

Another special package was prepared for the students by General Motors Diesel. The literature included: (a) a letter from the investigator describing tour arrangements; (b) two coloured photographs of the diesel locomotives that the students would see being assembled; (c) a two-page bulletin, "What makes a diesel tick?"; and (d) a brief history of how the company came into being. The package was addressed to each student and was given out in class two days before the tour .

Display Material

There were several pieces of eye-catching equipment in the plant which were used as bases for economic signs. Each sign carried the heading, "Dollars at Work", and the notation, "Amount Invested per G.M. Employee—$8500.00". One poster was designed to show the investment in one department while another illustrated the breakdown of stockholders, employees and consumers. Three colours were used for greater effect and the signs were all mounted on easels for easy visibility.

Preparation of Scripts

The scripts used by Mr. Rippingille and Mr. Warner were developed by Mr. T. Pisel of the General Motors Institute. Emphasis was placed upon diversified ownership:

> "Today G.M. is owned by 445,000 men and women. The vast majority of these owners, about 367,000, are individuals. It may be interesting to realize that the number of owners or stockholders is only a little smaller than the number of employees. In 1950 General Motors had over 465,000 employees."

The script used by the guides was prepared by the investigator. The material was co-ordinated with the display material; e.g., the sign on the Dominion bridge crane was the signal for the following talk about how capital lightens the job load:

> The job of building locomotives is classed as "heavy industry". Many of the component parts weigh a great deal—for instance, a locomotive assembly weighs 100 tons, and yet an operator can lift it by moving a lever. Modern technology has removed many of the back-breaking jobs so common in industry a few years ago. This *Dominion bridge crane* does the job quickly and easily. It required an investment of $90,000.

This speech was made doubly effective in some cases because the students saw the big crane in action.

Sales Dollar Presentation

The profit picture was cleverly demonstrated by means of an exhibit using a combination of two charts to represent a locomotive. The outside chart was in vari-coloured sections that could be swung down to expose the amount of the dollar and how it was expended.

Handouts

The General Motors Corporation believes in publications as an effective channel of communication. From a wide selection the committee chose to present to the students a copy of the Annual Report, 1950; "G.M. Folks," a corporation magazine that was featuring a section on the Annual Report; and an educational pamphlet, "Diesel, the Modern Power".

The Plant Tour

The General Motors Diesel tour was held on April 10, 1951. The students were brought out to the plant by bus at company expense. The general tour pattern was similar to McCormick's with the exception of the additional guides. A late start and the large number of groups disrupted the time schedule so much that the question and answer period had to be omitted. Contrary to expectations, the girls showed as much interest as the boys in the manufacturing operation. A number of persons, interested in seeing the socio-economic plant tour in action, sat in on the sessions as observers. These included Dr. J. A. Wheable, Superintendent of Schools for London; Archdeacon Townsend, chairman, Board of Education; Mr. L. Sipherd, Dean, School of Business Administration; Mr. L. W. Downie, President, Kelsey Wheel, Windsor, Ontario; Mr. S. Campbell, educational representative of the London Chamber of Commerce; Mr. McWilliams, principal, Beal Technical School; Mr. Johnson, principal, Beck Collegiate; Mr. Davies and Mr. Hilmer of the Department of Education in Toronto.

Summary

The tours established the fact that high school students are eager to find out more about business and that, if necessary, they are willing to give up their own time to do so. The industries were equally eager to help the students and cheerfully absorbed all expenses connected with the visits.

It was obvious that the students enjoyed the tours and took an intelligent interest in the material presented to them. On the whole, the tours went off as scheduled with the exception of the two-week lapse between them.

In the fall issue of The Quarterly, Mr. Wettlaufer concludes with an evaluation of the socio-economic plant tour as a teaching medium—based on the showing of the high school student on a second questionnaire.

Common Stocks As Long-Term Investments

Erle A. Steiss
Manager, Investment Department
The Canada Trust Company and The Huron & Erie Mortgage Corporation

Because of their past record, prevailing market conditions, and the nature of the times, Mr. Steiss endorses the purchase of common stocks as long-term investments.

DESPITE RECENT announcements* that the long-debated old-age pensions of $40 a month to be paid by the government to everyone over 70 years of age, without means test, are to become operative early in 1952, one of the most worrying problems facing middle-aged men in Canada today is how to provide for their own old-age security and that of their wives and children. Particularly is this true of salaried men and those living on fixed incomes. Income tax rates, already high, will be increased by a surcharge of 20% as of July 1st, and in his budget speech the Minister of Finance expressed the view that we have not yet reached the practicable limits of the income tax and that there was no assurance that tax rates may not have to go higher next year. In the meantime, there are rumblings in the press that it is not unlikely that to finance the universal old-age pension plan just referred to, the government may consider a new levy in the form of a payroll tax on employed persons and a special income tax on self-employed people. This new step in social security will cost the Federal Government approximately $250,000,000.

Increasingly difficult as the high income taxes and the prospects of even higher rates are making it for a salaried man to put anything worthwhile away for a rainy day or for his old age, his position is being impaired and threatened even more seriously by another process which, particularly in recent years and months, has been gnawing constantly into the real value of his income. This is the process of inflation with its serious effects upon the cost of living. Around the third or fourth day of every month we read in the press that the official government cost-of-living index has taken another substantial jump. As of April 1st, 1951, the most recent date* for which a figure has been reported, this index stood at 181.8 compared with an average of 166.5 for the year 1950 and 100 for the base period 1935-1939. Within the space of only fifteen years, our dollar has lost approximately 47% or nearly half of its purchasing power; and the greatest portion of this decline has

*This article was written in May, 1951.

taken place since the close of World War II. This explains why a $10,000 salary today is worth less than a $5,000 salary was worth in the middle thirties in terms of purchasing power.

Effects of the High Cost of Living on Real Income

In 1935 a married man who had no children and was earning a salary of $5,000 per annum had an income available after taxes of $4,880. Now, however, the same man with a $5,000 salary after deducting income taxes at 1950 rates and adjusting the balance for the higher cost of living as compared with 1935 has remaining to him a purchasing power in terms of 1935 dollars of only $2,470. Similarly a man with a salary of $10,000 had an income of $9,380 after taxes in 1935, but the same salary now after deducting higher income taxes and adjusting for the higher cost of living is worth only $4,587, as compared to the $4,880 which a $5,000 salary produced in 1935.

Many middle-aged men may be thinking in terms of pensions to be paid to them by their companies upon retirement at, say, age sixty-five. For purposes of discussion let us consider a pension of $200 a month. In 1935 such a pension produced a net annual income of $2,388 after income taxes. In 1950 there would have been no income tax payable because of the additional exemption allowed individuals over sixty-five years of age. But the increases that have taken place in the cost of living have reduced the real value of a $200 a month pension to $1,320 now, equivalent to $110 a month. Thus it is seen that the increases in the cost of living that have taken place during the last fifteen years are taking $90 a month out of the $200 monthly pension cheque.

Let us examine the case of a man who had saved an amount of $50,000 to provide for his and his wife's old age. He invests this amount in Dominion of Canada bonds. In 1935 he could invest in bonds at 4½%, which on $50,000 gave him a return of $2,250 less $8. income tax leaving a net of $2,242. Now, however, he can get approximately only 3% on a Dominion of Canada bond which gives him a return of about $1,500 a year. He has no income tax to pay, but after adjusting for the higher cost of living he has an income in terms of 1935 dollars of only $825 a year, indicating that his real income is reduced to almost one-third of its 1935 level.

As an even more striking illustration let us consider the case of a man leaving an estate. Here the problem of succession duties comes into the picture. When this additional factor is considered together with lower interest rates, higher income taxes and rising cost of living, it means that a man has to leave an estate of more than $400,000 today to produce for his widow the same real income in terms of purchasing power as a $100,000 estate produced fifteen years ago.

It is as a consequence of these factors that among the most pressing problems facing trustees and executors of trusts and estates today are those of maintaining the real incomes of widows or other beneficiaries in the face of a continually rising cost of living; and conserving the real value of the capital of the estate or trust in the face of an almost constantly depreciating dollar. These problems become even more frightening when it is realized that for more than one hundred years the long-term trend of the purchasing power value of money has been going down.

Bonds and Preferred Stocks No Solution

Wars have been the predominant, although not the only, cause of inflation splurges: but it is interesting to note, first, that in none of the post-war periods of corrective deflation did the value of money recover more than a portion of its former purchasing power; and, second, there was no corrective deflation at the close of World War II but, in fact, inflationary forces proceeded at what appeared to be an accelerated pace.

The question arises, then, how can an executor maintain the real income for the widow or other beneficiary of an estate under administration and conserve the real value of the capital for the remaindermen; and how can a man building up an estate for his and his wife's support protect himself against this steady erosion in the value of the money he is saving? It is quite clear that investing all of the funds in bonds will not assist in this problem. They are merely obligations to pay a fixed number of dollars at due date with a fixed rate of return in the meantime. Similarly, preferred stocks or any other form of fixed income bearing security do not provide the solution.

Do carefully chosen common stocks provide the means whereby an investor can protect himself against serious loss from inflation? History has shown that there is no perfect hedge against inflation, particularly in the field of securities, but that a fund invested at least partially in common stocks provides, over long periods of time, a substantial degree of protection. Recently a recognized American economist published a study on this subject in which he gave figures showing that in the U.S.A. the percentage gain in common stocks over the past sixty years has been almost identical with that of the cost of living, and that except for short periods the two curves have run close together.

Common Stocks Show An Excellent Record

Unfortunately, many people regard common stocks with a grave suspicion. This is largely due to their recollection of large losses suffered by those who were carrying stocks on margin during the 1929 crash, or those who were playing a "get rich quick" game by over-commitments in new, unproven and risky stock promotions. Such people cannot be regarded as investors and common stocks should not be judged

on the basis of their experience and results. Let us see what happened to a man who purchased a cross-section of common stocks of what were considered sound, well-managed companies in, say, April, 1927; paid for them outright, and continued to hold them. In relation to the level of stock market prices during the twenties the year 1927 cannot be considered to have been either a high year or a low year in the stock market, but rather it could be described as more or less of an average year. Let us assume this man put approximately one thousand dollars into each of the following 25 common stocks making a total investment of $25,000: Steel Co. of Canada, Massey Harris, Page Hersey, Canada Cement, Goodyear Tire & Rubber, National Steel Car, Bank of Montreal, Bell Telephone, Consumers Gas, Brazilian Traction, Montreal Light, Heat & Power, *C.P.R., Lake Shore, Noranda, International Nickel, Hollinger, Consolidated Mining & Smelting, McIntyre, Imperial Oil, International Petroleum, Abitibi, Price Bros., Maple Leaf Milling, Canadian Canners and Canada Bread.

It is interesting to note that in April, 1951 this fund was worth approximately $50,000, or double the original investment, even after paying out in each year all the dividends received which produced an average annual income of 6.10 per cent. These are the results achieved over a twenty-four year period in spite of the fund having passed through the worst depression and the worst stock market crash that the world has ever experienced, and without the benefits of any investment management being applied to it. Surely such a record demands a considerable respect for common stocks.

Object Lessons in Stock Investment

There are other interesting features revealed in this study. Of the 25 stocks, 10 stocks still showed losses in 1951, but the substantial gains in most of the other 15 offset these losses and brought the net result to double the original investment. These figures would seem to provide an object lesson to demonstrate the wisdom of diversification in investments. Imagine what the results would have been if instead of putting one thousand dollars in each of 25 stocks, twenty-five hundred dollars had been put in each of 10 stocks and the investor had been unlucky enough to pick the 10 bad ones! Another feature has to do with the matter of investment management. It is quite likely that if the fund had been placed under the supervision of a competent investment manager, a great many of the declining stocks would have been replaced from time to time during the 24 year period from 1927 to 1951 with other more promising and attractive stocks, with the consequence that a better performance both from standpoint of yield and capital appreciation

*In the case of Montreal Light, Heat and Power which was expropriated by the Province of Quebec in 1947, it was assumed for the purposes of these calculations that the proceeds were invested in Shawinigan Water and Power shares.

could have been achieved than the 6.10 per cent income return and the doubling of capital values.

If the man who had invested in this fund was faced with the necessity of raising a substantial amount of cash for reasons of illness or any other cause, and had no other assets on which he could realize, and if this necessity arose at a time when the stock markets were low as in 1932, he naturally would suffer a substantial loss if he were forced to sell all or a considerable portion of his stocks. For this reason it is wise and expedient and a part of sound investment policy to always maintain a considerable portion of a fund in readily marketable high grade bonds. What proportion should be maintained in bonds and what proportion in stocks depends, of course, on the individual's circumstances and no general rules can be given. For many people, however, a fifty-fifty proportion has been considered suitable.

The Principles of Stock Selection

At this point, two questions come up for consideration. The first question is how should one select common stocks. Although it is difficult to generalize, there are four principles which should be followed in any conservative approach to the use of common stocks: first, the company should be in sound financial condition; second, it should be engaged in a basic and growing industry; third, the company should be one of the leaders in its field; and last, but by no means least, it should be well-managed. It is not difficult to apply the first three tests. The last one requires a great deal of study and investigation, but because of its importance it is the policy of the writer's company to spend a great amount of time in calling upon the heads of companies to discuss with them their operations, problems and policies—all with a view chiefly to sizing up the calibre of the management. Only by such a policy should investments be selected and a fund managed and never should reliance be put on rumour, hearsay, tips and "hunches".

Why the Stock Market May Decline

The second question is, "Are stocks not so high now that there is a considerable danger of another crash similar to the one in 1929?" Among the reasons why this question frequently occurs are the following:

(1) Stocks have come up a very long way indeed from their lows of 1932, and neither the stock market nor business conditions can be expected to keep on going up forever. Most of the recognized averages of industrial stock prices are today at a higher level than they have been at any time since the peak of prices in 1929. Based on the market quotations for their shares, some companies are today selling for more than the entire industry in which they are engaged could have been bought in 1932.

(2) Recently increased corporation income tax rates to a level of 52.6% will cut deeply into the profits of many companies this year. In the face of these increased taxes there are quite a number of companies which cannot take much in the way of a reduction in net earnings without jeopardizing present dividend rates.

(3) In some lines of consumers' goods, there are indications that markets are saturated and sales resistance is increasing sharply.

(4) There is also some anxiety about the prospect of a so-called "conversion recession", meaning a lull in business while some industries are shifting from normal civilian production to defense work.

(5) The international situation remains very nervous with the ever present threats of fresh outbreaks of trouble in new and unexpected quarters. Psychological factors play a very important part in short term swings in the market. During 1950 they gave the stock market several severe shocks from time to time.

(6) We are still in the midst of an economic experiment of almost world-wide proportions. This experiment began on this continent in the early thirties with the introduction by governments, through their central banks, of artificially controlled interest rates to replace the former natural laws of supply and demand. It is still too early to tell whether the natural laws of supply and demand will eventually reassert themselves. This makes the problem of forecasting economic conditions, particularly for the short term, exceedingly difficult. With these artificial controls, economic factors alone can no longer be relied upon but must be considered together with probable government policy. As many in the financial business have experienced recently, the matter of forecasting the future course of interest rates, which have such an important bearing on business conditions, has become little more than a matter of trying to read the minds of the central banking authorities.

These and other difficulties may well make for wide fluctuations in the stock market and produce from time to time periods of considerable decline. But for the purposes of considering the purchase of common stocks as long-term investments, we are primarily interested in long-term and basic trends rather than short-term swings.

Some Favourable Market and Business Conditions

Now let us examine some of the fundamental facts pertaining to business conditions and the stock market in Canada today, and then let the reader decide for himself whether the present situation parallels that of the period immediately preceding the stock market crash of 1929:

(1) Most leading Canadian companies are in a stronger financial position than they have ever been before. Debt has been drastically reduced and working capital is high. During recent years a large per-

centage of earnings has been retained and ploughed back into business rather than paid out in dividends.

(2) There are as yet no seriously top-heavy inventory problems of the kind that were so disastrous in 1929, and profiting from the lessons of 1929, businessmen in general have adopted exceedingly cautious inventory policies, making reductions upon the first signs of any abnormal accumulation.

(3) Unlike 1929, stocks today are held in extremely strong hands. In 1929, there was a great deal of margin trading. In contrast to twenty-two years ago, brokers' loans are at extremely low levels and the great majority of stocks are purchased outright by insurance companies, investment trusts, pension funds and individuals for long-term investment, rather than for short-term capital profits. The demand for common stocks from these institutions and individuals is growing at a rate far greater than is the supply of common stocks.

(4) We have seen over the past several months a stiffening of interest rates; and it should not be ignored that if the present upward course of interest rates were to continue to higher levels and remain permanent, it would undoubtedly have an important effect on stock market levels in inducing many corporations and individuals to switch back again from stocks into bonds. But despite this recent rise in yields on high grade bonds, the yields obtainable on common stocks are still substantially higher than on government bonds. The margin in favour of stocks is widened further by the fact that an individual can deduct 10% of dividends received from Canadian corporations from his personal income taxes. Also, even though interest rates may go to somewhat higher levels in the not distant future, it is not very likely that we will see interest rates climb to, and remain permanently at, substantially higher levels.

Governments have been much too successful in furthering their economic and social welfare aims through their "easy money" policies to suddenly scrap them. Furthermore, with the prospect of large-scale defense spending facing them, governments may have to borrow heavily again and it is obviously in their interest to borrow at low rates. In any event, even though bond yields may go somewhat higher and even though dividends may be reduced by some companies because of the higher corporation income taxes, we are still a long way from anything like the situation which prevailed in 1929 when stocks were selling so high as to yield actually less than high-grade government bonds. At the peak in 1929, the yield on a representative group of stocks listed on the New York Stock Exchange was less than two-thirds the yield obtainable on a representative list of high grade bonds.

(5) Earnings are still being capitalized at the lowest level, with the single exception of the 1946 break, for any term for which data are

available, viz: 1929 to date. The price-earnings ratios at which stocks are selling today are lower than prevailed even at the 1932 bottom in stock prices. This factor is of fundamental importance inasmuch as earning power is still the biggest influence in the appraisal of stock values.

As a typical illustration of this point, let us look at some of our leading Canadian stocks. International Nickel is currently selling at 37, or between eleven and twelve times 1950 earnings of $3.21 a share. In 1929 International Nickel earned $1.47 a share and sold as high as 73, or fifty times earnings. Similarly Consolidated Mining & Smelting is today selling at approximately eleven times earnings as against thirty-three times earnings in 1929; Massey Harris at six times versus thirty-six times; Ford "A" at four times versus twenty-two times; Bank of Montreal at sixteen times versus twenty-six times; Steel of Canada at eight times versus fourteen times; Canada Cement at ten times versus eighty-five times; Abitibi at seven times versus thirty times; and Shawinigan Water & Power at eighteen times versus forty-eight times. These figures show that we are still a long way from indulging in anything like the speculative excesses which were the rule in 1929.

(6) While we are bound to continue in the future to have recurring fluctuations up and down in general business conditions, which will have their effects on the levels of stock prices, it must be recognized that governments now exercise an influence on business conditions which is far greater than has ever been the case before. This influence is being exerted in several ways:

(a) Through their control of central banks, governments can, through changes in the supply of money and credit and other monetary actions, set in motion important and far-reaching forces of inflation or deflation at will. Through these means, coupled with governmental spending projects, it has already been shown that governments can do a great deal to arrest the forces of deflation in a period of declining business. Governments are keenly aware of the tremendous power they possess in this control of monetary action and it can be taken for granted that in periods of business decline and unemployment they will do everything possible to revive business conditions. This is true of whatever political party holds office, because any government which does not use these powers to avoid unemployment and bread lines will soon find itself replaced by one that will.

(b) Declines in the prices of farm products resulting in a low purchasing power among farmers have been one of the most common causes of business recessions and depressions on this continent. For many years, however, the governments of both the U.S.A. and Canada have been actively maintaining the purchasing power of the farm population through price support programs, direct subsidies and other

methods. There can be little doubt that this attitude of governments toward the farm population is here to stay. The political power of the farm classes is tremendous.

(c) Similarly, it is quite evident that in both the U.S.A. and Canada governments have been extending a considerable protection to collective bargaining for labour and to union organizations with the result that the labouring classes are obtaining an increasing proportion of the national production in the form of wages. This has resulted in a tremendous increase in the purchasing power of the masses, which has been without doubt one of the key factors in the unprecedented demand for consumers' goods of various forms during the past decade. Coupled with this, governments are constantly pumping vast sums of money into the spending stream through large scale and ever-increasing social security programs such as the baby bonuses, old-age pensions and other forms of special subsidies. All these factors are highly inflationary in character and are almost certain to continue because of the enormous political power of the labouring class.

Thus we see that the farmers and the labouring classes have been among the principal beneficiaries of the spending and inflationary policies of governments. Because of the tremendous political power of these classes it can be taken as virtually certain that the great bulk of these governmental spending policies will be continued with consequently important implications on the purchasing power of the masses which is so important a factor in maintaining a high level of business activity.

(7) In addition to all the above factors, armament orders will likely continue for many years; and so long as industry will be kept busy on defense production, with the main stimulus of defense spending still to come, it is difficult to visualize anything but a strong industrial outlook.

(8) Finally, surely no one can doubt that we are in the midst of a great and vigorous industrial expansion in this country based chiefly on the development of our natural resources. Common stocks are the only way in which as an investor in securities, one can share in this growth that is taking place in Canada, and this provides a further strong argument in support of a positive attitude towards common stocks.

Conclusion

It is against this background that it seems desirable that an average businessman's investment portfolio should contain a portion of common stocks; and that the interests of both life tenants and remaindermen in the case of estates and trusts appear to be best served by including a percentage of well selected common stocks. In this connection it is important to point out, however, that an executor or trustee is powerless

to include common stocks unless the terms of the will empower him to do so. In the absence of such powers being expressed in the will, an executor is restricted on any new investments which he makes to trustee securities, which in Ontario and in all other Canadian provinces means government, provincial and municipal bonds, loan company debentures, trust company guaranteed certificates and certain types of mortgages. Testators can provide in their wills for powers to go beyond the field of trustee securities, and the commonest practice is to permit executors to purchase securities, including common stocks, which are eligible for Canadian Life Insurance Companies. The writer's company has followed a policy of recommending the granting of such powers in the will so that the executor may exercise his discretion in placing some moderate portion of the estate in common stocks when the time for such action appears appropriate, and when other circumstances surrounding the estate permit.

The Trustee Act in Ontario has not been revised for many years and its investment provisions have not been brought into line with present day conditions. It is interesting to note, however, that last July the State of New York became the twenty-fifth state in the U.S.A. to permit trustees to invest funds under their management in common stocks. The New York State statute permits trustees to place up to 35% of trust funds in common stocks. There has been a great deal of support recently for similar revision of legislation here in Ontario, in order that estates and trust funds might not be excluded from sharing in the benefits of the growth in our Canadian trade and industry.

Creative Leadership in a Middle-Class Society

Rev. George W. Goth
Metropolitan United Church

"It is refreshing to find a minister who makes it a point to relate his sermons to basic problems businessmen wrestle with from day to day. The Reverend Mr. Goth is one of those ministers of the Gospel who speaks courageously and knowingly of some of our more basic economic issues. Many of the readers of this article will not wholly approve of his statements but we feel that there will be few who will not admit that this sermon provokes thought. We welcome the opportunity, therefore, of presenting our readers the text of Mr. Goth's sermon which was given in the City of London in April, 1951."*

THE TIME has come for someone to speak out against the perils of mediocrity. Most of us are satisfied if we can make a pass mark. The desire to excel has been dampened by the greater urge to conform. We do not like to be distinctive. We have been reared in an era when the aristocratic virtues have been at a discount. This has not been a good day for kings. Old orders have been liquidated, dynasties have been overthrown, and the common peoples of the world are in the throes of revolution. Jean Jacques Rousseau was perhaps the most disturbing factor in modern history. It was he who identified the voice of the people with the voice of God. The people, he shouted, were naturally good. Release them from their chains and inhibitions, free them from the shackles which governments and churches have forced upon them, and their own spontaneous goodness will make them the most amiable of creatures. That was, quite probably, the maddest nonsense that has ever been proclaimed. Man, if left to himself, is just as apt to fulfill Thomas Hobbes' analysis and become nasty, brutish and cruel. Yet it would be folly to suggest a return to those imaginary good old days when one small class of people dominated the total picture. You can't put back the clock.

The Perils in Our Virtues

One of the unfortunate weaknesses in man is that while he can see the evils in other systems and values he is peculiarly blind to the limitations of his own. Thus a great many of our public men, who ought to know better and would if they had any creative imagination, have

*Lloyd W. Sipherd, Dean, School of Business Administration, University of Western Ontario.

come to identify our way of life with the ultimate. There are perils in our position too. As a matter of fact, among the forces that two thousand years ago compassed the death of Jesus of Nazareth, there are three at least in our modern world which we have exalted to the rank of cardinal doctrines.

What Do They Mean By "Equality"?

The first is the doctrine of equality. As regards the theory, no one ought to have the slightest complaint to make. Men ought to be born free and equal in the eyes of the law, though one doesn't have to look very far to know that even this is an ideal which human society has hardly begun to approximate. We have no illusions about it. That men are not born free and equal in any other respect we know without being told. Circumstances and blood take care of that. Everyone, to be sure, is equal in the eyes of God. Moreover, each will be expected to render an account commensurate with the talents which God gave him.

There is the very grave danger that we are carrying this doctrine of equality too far. We have clung tenaciously to the illusion that everyone is as good as everyone else, and has just as fine a chance to be successful and envied. We, on this continent, have been fed on success stories such as: "From log cabin to the White House". If this spirit of equality means that all must measure up to a high standard then it is an excellent thing indeed. But if it means a levelling down, which it does mean quite often, then we are in mortal peril. Granted, there should be no room in a Christian society for false and unethical divisions. Inherited wealth and ancestral pride have little place in a truly democratic society. But this present attempt to say in the name of Christianity or Democracy that there are no distinctions *at all* is sheer madness. It has debauched our literature, broken down our behaviour patterns and standards, and made us conform to the lowest common denominator.

There is such a goal as the aristocracy of character and achievement. The poems of Shelley are surely of greater artistic value than the pleasant little verse of Edgar Guest. The man who offers blood, tears, toil, and sweat to his task ought to have a greater reward than those who are clamouring for shorter hours with more pay. The preacher who gives himself wholly to his congregation, who doesn't count the extra hours, and doesn't expect double pay for overtime is likely to be called to positions of responsibility. Is it unfair to suggest that he has earned whatever advantages may have come to him? Surely, in any walk of life, the irresponsible who gives as little of himself as he can is not the equal of one who is consumed by an overwhelming purpose.

The scribes and pharisees got the idea that no one could possibly be any better than they were. Because of this a young carpenter from

Nazareth died on a cross. In a fine spirit of complete equality they drove nails through his hands and feet. That word "equality" has always been a word to send shivers down the spine. The French got it on their lips in the Revolution—*Liberty, Equality, Fraternity*—and all they could think of was cutting off other people's heads to demonstrate their blessed oneness. Our middle-class society is in danger of reaching the stage where the hut tears down the palace, and the gutter stones the saint, and after a while everybody is on a level with everybody else.

Let us be honest and confess that we sometimes get our signals crossed. Jesus Christ had nothing to do with the building of a cheap little world where discipline and character were at a discount. He lost His life in it. He was not the champion of the underdog who wanted to get on top. He was the champion of human personality wherever it happened to be, which is an amazingly different thing, and of its inalienable right to grow in the image of God. Artificial distinctions—wealth, position, and social prestige—were nothing to Him. Genuine distinctiveness—justice, mercy, and love—were everything. His whole kingdom was an aristocracy, an aristocracy of spiritual stature. There were lordships and degrees of nobility: "Thou has been faithful over a little, I will make thee ruler over much." There were leaders and servants; that is, men and women who by sheer moral courage and spiritual virtue were high and lifted up. Equality, a state where everybody was the same, was a thing for pygmies to snatch at, until only pygmies were left; then they could all chuckle together, rub their hands and call it "democracy."

What we need to learn is that there are values worth striving for, goals to be reached, and prizes to be won. "Let him who would be great among you be the servant of all." God has His gentle folk and His peerage, and the ones who sit with Him may not be the wise, the mighty, and the noble. But this one thing is sure. We live in a world of genuine distinctions. Otherwise our striving is a vain pursuit. The man of character is superior to those who waste their substance. If equality means reducing one's stature so that all may crawl in through a common hole then we had better be on our guard. Our task is surely to grow, to excel, to cultivate the aristocratic virtues in a democratic society.

Is Self-Sufficiency Enough?

Second, in the democratic tradition is the worshipful doctrine of "rugged individualism." It goes about saying: "Let me alone. I can stand upon my own feet. I'll get there, and everything will be fine. Quit meddling with me." Adam Smith had much to say about this doctrine. Let everyone fix his own price (only it isn't done that way any more) and live his own life and reap his own profits; and something in the nature of things called "the economic balance" will offset

everybody's selfishness if you stop fooling about it. It is what the author of *Anthony Adverse* describes as "a sort of cat philosophy" in that scene where the young hero first climbs the high wall around his little world and gazes out on the wide, strange earth, wondering what it means. Suddenly along the eaves from one end of the roof to the other slinks a cat with a pigeon in its mouth. "Ah," whispers the lad in effect, as a light goes out of his eyes, "so that's it."

The Master went to a cross because He knew that there were laws which transcended self-interest. The disciples who ran away were, very likely, rugged individualists.

Moreover, we ought to know that our economy has never been completely free. The business man yelps and protests if the Western farmer asks for a subsidy for his wheat. Yet at the same time in order to protect the manufacturer the farmer has to pay much more for his machinery. Tariffs are a form of subsidy to the labourer and manufacturer.

The truth is that we are not sufficient unto ourselves. Each one needs the other. Even Jesus was dependent upon others. Think of Him, a homeless Jew, who has just slept in a borrowed room, riding on a borrowed colt.

An American friend wrote a vigourous letter the other day in reference to the great debate. "America," he said, "can go it alone. She is sufficient unto herself." No one is self-sufficient in an interdependent universe. Too often in the past we have marched through life with hob-nailed boots, plucking all that came within our reach, tossing crumbs in the form of charity to the beggars by the wayside. How far we have travelled from the gospel which placed a servant at the centre! We have defamed it by ignoring it, and how angrily we would defend it if someone were to denounce it with his lips. Dr. David James Burrell tells a story of George Matheson, the author of the hymn: "O Love that wilt not let me go." Matheson stood with a few of his friends on the rocky coast of Ireland, his sightless eyes turned toward the sea, the scent of the salt wind in his nostrils, and the feel of the moving blueness in his soul. Suddenly he drew a deep breath and threw his arms around the two who were nearest to him, whispering to them, "Isn't it beautiful?" "Do you know?" answered one. "Yes," came the answer, "I know, and much of it through you."

Don't let us talk so much about standing alone. God in His mercy and wisdom made us members one of another. If we carry the doctrine of rugged individualism too far we shall lose those qualities in free enterprise which we cherish. Free enterprise will not be saved by defending an order whose sun has never set. It can be defended by magnanimity, sharing and reward for consecrated service. We build on firm

foundations insofar as we accept these words and make them our own: "Bear ye one another's burdens and thus fulfill the law of Christ."

How Far Can We Trust the Majority Vote?

Finally, our thought has a direct bearing on the third emphasis of our democratic psychology—built up out of the working of the middle-class mind—the doctrine of the majority vote. We think somehow that if we can weigh all the pros of popular opinion on one side and all the cons on the other we can tell at a glance what is best for everybody. Two or three years ago a candidate for mayor in one of our cities was asked what he had to say about Sunday sports. His answer was scarcely one that should place him in a position of leadership: "The people seem to want Sunday sport," he said. "That's progress." Is it? Put to the popular vote the question—Shakespeare or a popular movie—and what would the answer be?

Whenever the assertion is made that something must be true because everybody says so it might be well to recall the scene when Christ was about to be crucified. As a concession to the Jews it was the custom at the feast to release a prisoner whom they desired to be free. Barabbas was a robber and a criminal. One would have thought that if the voice of the people were the voice of God they would have asked for the release of Jesus. But they didn't. They called for the release of Barabbas. And what happened to Christ? We can hear the cry unto this day: "Let him be crucified." Jesus died because in a popular election the majority of votes was cast for Barabbas. Surely then we ought to beware even of our virtues, to be on guard against our most treasured possessions!

This calling into question of the "sacred cows"—the accepted doctrines of equality, self-sufficiency and the majority vote—may look to many like heresy. But it is precisely because these three doctrines are valuable that they should be rescued from their friends. Harry Emerson Fosdick said many years ago that the hope of the world lies in minorities, in saving remnants. The masses are not given to thinking, Therefore there must be room in a creative society for the nonconformist, for the distinctive individual, for the man who, through character and discipline, is qualified to live above the average and ahead of his times. Civilization has grown when someone like Abraham has gone up front and challenged the rest of us to follow him. The creative individual does not follow. He leads.

The Challenge of Our Times

Our middle-class society is in peril today. We shall not save it by a puny defence. We can save it by going on. Equality, yes—but not an equality which drags us down to a dull, unimaginative level, but an equality which challenges us to measure up to the highest. The growth

of enterprise and personality, certainly, but not a rugged individualism which becomes ragged and reactionary. The will of the people must prevail—but let that will be disciplined and based upon an appreciation of what is best.

It will be good for us to shed some of our illusions. Jesus was not crucified by wicked people. He was crucified by nice people like us. Some of our deepest prejudices to which we have been born, and in which we have been trained, are dead set against Christ. That ought to jar us. We too have been transfigured, disenthralled. Great humility and a fresh re-orientation are required on our part if this is to be our finest hour.

The little man, and there are so many, wants to crucify anyone who threatens his own petty security. He cries out that the whole universe is threatened. The big man, and we need more of them, is prepared to lose himself and some of his virtues and prejudices, so that out of the womb of these stirring times God's kingdom may come "on earth as it is in heaven."

How Some Companies Are Handling Salesmen's Car Expenses

James D. McKnight

Canadian sales managers are continually endeavouring to determine the most economical and efficient way of operating the salesmen's cars in their particular business. To help those executives who may be dissatisfied with present methods and to give them some idea of how other companies are handling the problem, a number of selected Canadian manufacturers were surveyed. No attempt was made to select specific companies, nor were size, nature of the business, or known methods of handling these expenses allowed to influence the selection of the sample. Rather, it was hoped that each province would be represented in proportion to its relative importance as a trading area, and that all sizes and types of manufacturers would be included.

Mr. McKnight notes, "The replies to our mail questionnaire have been used exclusively in compiling the current information contained in this report. Where possible, comparisons have been drawn with the results recorded in a similar survey conducted from the School of Business in 1937. Current results obtained on company-owned fleets pertain almost exclusively to Ontario and Quebec, for 90% of those replying are located in these provinces. On the other hand, each province, except Newfoundland, is represented in the results pertaining to salesman-owned fleets."

The results of this survey are in no way intended to portray the ideal method of handling salesmen's automotive expenses. In the final analysis this must be determined in the light of the circumstances surrounding each individual company.

ONE OF THE MOST controversial, and yet most important points to be decided in fleet operation is who should own the cars—the company or the salesmen. Current results have been tabulated as follows:

Number of questionnaires mailed	126	
Number of replies received	68	(54%)
Number of incomplete or late returns	3	
Number of companies with company-owned fleets	17	(26%)

Number of companies with salesmen-owned fleets	45	(69%)
Number of companies with both company and salesmen-owned fleets	3	(5%)
Total number of cars in 65 companies	2391	
Average number of cars operated by each company (of which 1287 or 54% are company-owned and 1104 or 46% are are salesmen-owned)	37	
Average number of cars in company-owned fleets	64	
Average number of cars in salesman-owned fleets	23	

One company, in addition to operating a salesman-owned fleet, reports very favourable results in operating a large fleet of cars under a rental contract. This leasing arrangement is one of the more recent developments in administering salesmen's cars and will likely exert a greater influence in time. It is still relatively undeveloped here in Canada, but is receiving wide attention in the United States, where a large number of companies are utilizing these facilities.

Another company, operating a fleet of 65 cars, went from salesman-owned to 100% company-owned cars within the last two years. They claim considerable savings over the *monthly allowance plus cents per mile* basis of remuneration to salesmen, used previously. They also claim better maintenance and repair of vehicles, since in their experience salesmen were reluctant to spend sufficient money to keep their cars in first-class condition. Other reported advantages of operating a company-owned fleet are:

(1) Promote salesman goodwill, creating an incentive for superior sales effort.

(2) Enhances prestige of the company. Better cars are provided than salesmen would provide for themselves.

(3) Implies fleet discounts and better delivery on new cars. If cars are scarce transportation for salesmen can be be assured regardless of changes in sales personnel, and cars can be traded in whenever it is deemed advisable.

(4) Permits promotion or hiring of personnel who, through not owning a car, might otherwise be unable to accept. At the same time the company is not obliged to finance the purchase of a salesman's car.

(5) Helps assure that the salesman will cover his territory adequately, regardless of the condition of roads or weather.

(6) Means less danger of underpaying or overpaying the salesman. Promotes more rigid control of operating costs.

(7) Permits use of the car for transporting goods and advertising material that the salesman might be reluctant to carry in his own car.

(8) Does not burden the salesman with auto expenses he is incapable of handling if his remuneration is on a lower scale.

In the past it was felt that a company-owned car could, by means of paint, art-work, distinguishing marks ,etc., provide a suitable advertising medium. However, the present survey indicates that 90% of the company-owned fleets use no such identification. Only two of the companies reporting, use decalcomanias or other art-work to advertise company brands, or identify the company. Most companies feel that it is not a particularly effective advertising medium, and that a car without identification marks enhances the salesman's self-esteem and fosters his pride of possession, thus encouraging him to take the best possible care of the car.

The Trend in Ownership Policy

The following figures illustrate the difference in current ownership policy from that recorded in the 1937 survey, expressed as a percentage of the total companies reporting.

TABLE I

Classification	*1951*	*1937*
Companies with company-owned fleets	26%	30%
Companies with salesman-owned fleets	69%	45%
Companies with both salesman and company-owned fleets	5%	25%
Total	100%	100%

Companies have swung sharply away from operating both company and salesman-owned cars in the same fleet, and the trend has been gradually away from company ownership of the fleet. Reasons advanced for operating salesman-owned fleets are:

(1) The company avoids tying up large capital investment in cars.

(2) There are no headaches over the detail work. An important saving in time and expense of looking after the cars, records, maintenance, insurance, etc., is claimed.

(3) With wide territory coverage it is impossible to centralize maintenance and service depots.

(4) A salesman takes better care of the car, if it is his own.

(5) When the fleet is small, or annual mileage not great, the economies of a company-owned fleet are largely unrealized; e.g. bulk purchase of tires, gas and lubricants, centralized maintenance depots, fleet discounts, etc.

(6) A salesman can choose his own car; has unlimited personal use of the vehicle; can trade it in when he wants to; feels more responsible and independent.

The general feeling seems to be that company-owned fleets are favored as being most economical when, in order to cover a territory adequately, a large number of cars are required and annual mileage is high. Executives feel that the cost of controlling such a fleet is then justified, and is more than offset by the economies effected. Conversely, when a company requires only a few salesmen and annual mileage is fairly low, salesman-owned cars seem to work out best.

The fact that these principles are being generally adopted may account for the following relationships as reported in the present survey:

TABLE II

Classification	*Company-Owned Fleet*	*Salesman-Owned Fleet*
(1) Maximum number of cars in fleet	208	75
(2) Minimum number of cars in fleet	9	1
(3) Average number of cars in fleet	64	23
(4) Maximum monthly miles per car	5000	3500
(5) Minimum monthly miles per car	400	50
(6) Average monthly miles per car	1450	1350

A Comparison of Operating Costs:

Considering *company-owned fleets* first, 85% of those companies owning some or all of their cars reported their operating costs on a cents per mile basis. The other 15% did not reveal this information. Reported costs ranged from 4.15 cents to 8.52 cents per mile. The range for 71% of these companies was from 5 cents to 7 cents per mile. This spread is remarkably narrow when it is considered that the results hinge upon several important variables. The make and model of the cars in the fleet, annual mileage driven, climatic and road conditions, size of fleet, items comprising total expense, amount of insurance carried, regional price differentials of cars, gas, lubricants, tires, etc., and trade-in policy all have an important bearing on these cost per mile figures .

One reason for this uniformity in cost per mile is that all the companies included among the items of expense which make up their total costs, gas, oil, repairs, license, insurance, depreciation, tires, lubrication, wash and polish. Twelve companies, whose average costs per mile were 1/5 cent *lower* than the average for the rest, reported under "other" expense such additional charges as accident allowance, parking, garaging, storage and tolls.

Only one company, with a fleet of 85 cars, reported interest on capital invested in their fleet as a part of their costs per mile. They included all the aforementioned expenses plus interest on investment at 6% in recording costs per mile at 7.9 cents.. At one time a highly

controversial point, it now seems to be resolved satisfactorily. Since it is not allowed as an exemption from taxable income, most companies consider this fleet investment as they would a machinery or building investment, maintaining depreciation reserves and charging depreciation expense only. It is felt that interest on fleet investment should be included, however, along with the additional operaitng and overhead costs borne by the company controlling its own fleet (whether exempt from income tax or not), when attempting to determine the relative economy of operating company or salesman-owned vehicles by comparing cost data.

Another reason for the uniformity in the cost per mile figures reported is, as already mentioned, that all companies reporting are located in Ontario or Quebec. This minimizes the divergent effect of regional price differentials on new cars, gas, lubricants, insurance, etc.; the trading areas covered are similar in size and extent, and climatic and road conditions are largely the same. Cost figures might well be somewhat higher in the Prairie Provinces and in the West and East Coast regions.

The average cost reported was 6½ cents per mile, with fleets ranging in size from 9 to 208 cars. This compares with the average cost reported in the 1937 survey of 4¼ cents per mile. It indicates that, in spite of greatly increased prices of every expense item, in the operation of their fleets Canadian companies have retained a tight control over theri costs.

Where the fleet is *salesman-owned,* the companies who remunerate their salesmen on a flat cents per mile basis (40% of those reporting utilize this method) pay them, on the average, 8.3 cents per mile. The range is from 6 cents to 10 cents per mile. This compares with the 1937 average of 5 cents per mile. The range then was from 3½ cents to 8 cents per mile, and practice was much less uniform than it is today. Remuneration within this range was extremely varied whereas present findings show a distinct concentration at the 7 cent to 8 cent level.

Companies differentiate their allowances to salesmen in accordance with varying climatic and road conditions, and differences in the cost of cars, service, and repairs, etc., which prevail among the various provinces. Highest allowances are given in the Prairie Provinces (10 cents per mile); the lowest in Central and Western Ontario (6 cents per mile). One company also differentiates between the lower cost of operating an English car as opposed to a Canadian car. Salesmen owning the former type receive 3 cents per mile plus $37.50 per month, while those owning the latter type are paid 4 cents per mile plus $40.00 per month.

The following table compares the methods companies now use to compensate salesmen for their automotive expenses with those used in 1937. Figures are expressed as a percentage of the total companies reporting in each year.

TABLE III

Year	*Cents Per Mile Allowance (1)*		*Flat Fee (2)*				*Combination of 1 & 2 (3)*	*Other (4)*
	Flat Rate	Sliding Scale	Day	Week	Month	Annual		
1937	41	6	2	4	4	2	15	26
1951	53		16	5	5		5	16

Table III suggests a trend away from a flat rate in favor of a sliding scale cents per mile allowance. Companies now report that they allow, for example, 8 cents per mile for the first 10,000 miles and 6 cents per mile thereafter; or 8 cents for the first 300 miles per week and 7 cents over 300 miles per week; or 8c for the first 5000 miles and 7 cents thereafter. The initial allowance is always somewhat higher to help cover the annual fixed costs of license, depreciation, insurance, etc. After that the lower allowance is largely for operating costs; e.g., gas, lubricants, repairs, etc.

In 1937 approximately one company in four remitted the salesmen's car allowance in some form of flat daily, weekly, or monthly allowance. At present only one company in eight reports using this method. Where in use, the average daily allowance is $3.00 per day within a 30 mile radius of headquarters; $4.50 per day in outside territories where driving conditions are good; and $6.50 per day in Saskatchewan, Alberta, Northern Ontario, and interior B.C. This compares with the 1935 range from $1 to $4 per day depending on location and area covered. Present weekly allowances range from $10 in Toronto ($13 for other city driving) to $20.00 for country driving. No comparable figures are available for 1937 weekly or monthly allowances, but present figures average $70 per month. Annual allowances are tied up with the salesmen's commissions and there is a bulk settlement at year's end, or when the salesman is released or retired; but specific figures were not offered.

Companies vary more on this question of how to pay a salesman for the use of his car than on any other point. Every method has its good and bad points, and there is presumably no one method that would be ideal for every type of business. At present over 40% of the companies reporting use some combination of a cents per mile allowance and flat fee, or some more individualistic form of compensation classified as "other", while in 1937 only 21% of the companies reporting were so classified. This indicates that companies are utilizing methods of compensation that are "tailor-made" to their own particular circumstances rather than adopting some more or less arbitrary method.

Some examples of combination payments reported are: 4 cents per mile plus $45.00 per month; 7 cents per mile plus $25.00 per month; 5 cents per mile and $5.85 per week (to cover depreciation only: the

company pays for the license and insurance in addition.) Payments are so varied to suit each situation that a break-down by averages is meaningless. In 1937 typical combination plans were 2½ cents per mile in Ontario and Quebec, and 2¾ cents in Western Canada and in the remote parts of other provinces, plus $25.00 per month.

In each case companies are guided by the principle that fixed charges cannot reasonably be handled by a mileage allowance, i.e., the man who operates his car, say, 25,000 miles a year will get too high an allowance, while the man who drives 8 to 10,000 miles will get too small an allowance to cover depreciation and other fixed costs. The sliding scale cents per mile allowance is aimed at overcoming the same difficulty.

Fifteen per cent of the companies operating salesman-owned cars reported that they pay all actual expenses as submitted by the salesman, on a voucher basis. Of these, three companies reported paying, in addition, a flat fee of $15.00 per month, $40.00 per month, and $5.00 per week respectively.

Regardless of the method or amount of remuneration, 81% of the companies whose salesmen own the cars feel that it adequately covers all items of expense including gas, oil, repairs, license, insurance, depreciation, tires, wash and polish, lubrication, and "other" costs. In this latter classification were such items as garage, parking, heated storage in winter, minor repairs, tow charges, and bridge tolls. No company reported feeling obliged to pay salesmen interest on their auto investment, and 19% think they should not be responsible for license, insurance, tires and miscellaneous expenses.

In the case of *company-owned vehicles,* one of the hardest things to control and one which may add considerably to operating costs, is the salesman's use of the car for other than business purposes. The following is a comparison of existing attitudes on this subject with those of 1937. Figures are expressed as a percentage of total companies reporting.

TABLE IV

Classification	*1951*	*1937*
Unrestricted personal use	50%	40%
Limited personal use	40%	40%
Not allowed for personal use	10%	20%

It is obvious that a more lenient attitude now prevails than in 1937. The companies who forbid or limit the use of their cars for personal transportation admit that their regulations are frequently violated, and that rigid control is well-nigh impossible. However, the 90% who do permit personal use of the car usually rely on the salesman's honour not to abuse the privilege and, usually, to make some reasonable contribution towards the cost of operation. They claim that results have

been very satisfactory. In most cases the company pays all the expenses but expects the salesman to pay from 2½ cents to 8 cents a mile when the car is used for personal matters. Occasionally the man is requested to pay for his own gas and oil, and in one case a flat annual charge of $75.00 is levied to cover overhead; in addition the man pays for his own gas and oil. Frequently companies limit personal use of the car to evenings and week-ends, discouraging long trips.

Companies with *salesman-owned fleets* are faced with a similar problem in trying to control the "padding" of mileage expense claims by salesmen. The present survey revealed that 59% rely solely on the salesman's integrity in this matter, while 41% check the validity of mileage claims submitted. Of those who check claims, 75% tally road map trip mileage (plus a small allowance) against daily or weekly reports and expense claims when submitted; 20% make irregular spot checks against speedometers; while the remaining 5% check vouchers against expense claims, calculate gas consumption, or allow only road map mileage between towns plus 10%.

One of the reasons advanced for operating company-owned fleets is that it avoids the necessity of financing salesmen when they purchase a new car. On questions put to companies with salesman-owned fleets regarding financing, the following results were recorded:

TABLE V

Question	*Yes*	*No*
"Is owning a car one of the conditions of employing new salesmen?"	65%	35%
"Does your company help salesmen finance the purchase of cars?"	65%	35%

Of those who do *not* give financial assistance, 71% said that owning a car was a prerequisite of employment. The remaining 29%, either because there was a company-owned fleet in addition, or some sort of leasing arrangement, admitted that they were able to provide cars for the salesmen who don't choose to own one, or who can't afford it. Other companies can carry on operations satisfactorily by having salesmen use other modes of transportation; e.g., rail, air, bus, taxi, car rental, etc., until they can afford a car. However, most companies do want their salesmen to own a car, and do help them purchase one.

This financial assistance is provided in one of the following forms (32% submitted no details):

(1) Interest-free loan deducted from payroll or commissions over an 18 to 40 month period 39%

(2) Loan at unspecified interest rate deducted from payroll or commission. Company reduces the total amount of the loan outstanding by their annual allowance to the man

for depreciation. (Allowances varied from $304.20 to $468.00 per year — averaging $417.00.) 22%
(3) Bank loan arranged for salesman 7%

The Treatment of Depreciation Expense

All companies reporting, whether operating company or salesman-owned fleets, record depreciation expense as a part of their total cost of operation. However, the survey revealed many divergent policies in handling depreciation.

In the case of *company-owned fleets,* 40% of the companies depreciate their vehicles in strict accordance with government income tax regulations (which seem to be quite liberal); i.e. 30% of the cost or residual value per annum. Except, of course, for purposes of filing tax returns, when they too would probably conform to government regulations, 60% of the companies attempt to handle depreciation on the basis of current market values for used cars. Hence they do not record quite as heavy depreciation expenses in estimating their cost per mile figures. Some depreciate their cars at 25% the first year and 20% thereafter of the original cost; others use a straight-line depreciation based on the original cost, ranging from 10% to 25% per year, while still others write off amounts ranging from $324 to $500 annually.

In the case of *salesman-owned fleets,* all companies reported that their remuneration to salesmen included an allowance for depreciation, but here too there was some divergence in the method and amount of this remuneration. The following methods were reported:

(1) Sum included in basic allowance and released to salesmen 62.5%
(2) Specific sum retained by company as a reserve 22.9%
(3) Specific sum released to salesman 14.6%

To more than three-fourths of the companies, depreciation is merely one item to be considered in fixing the basic amount to be allowed the salesman for the use of his car. Some salesmen, however, when they have the cash on hand, tend to spend it for immediate needs, rather than set any part of it aside for purchasing a new car. Hence some companies retain a specific amount in reserve, to be applied at the time of trade-in toward the cost of the new car; or to be given to the salesman in cash if he retires, or is released. Two companies replied that their depreciation reserves would be retained by the company only if, at the time, they were assisting the salesman to finance the car; otherwise the depreciation allowance would be released.

Allowance for depreciation varied from $300.00 to $540.00 per annum, averaging $400.00 — figures which compare very closely with those established for company-owned fleets. In contrast, the average 1937 depreciation allowance was $200.00 to $250.00 per annum.

Closely allied to the subject of depreciation is the question of *trade-in*

policy. The figures in the following table are expressed as a percentage of total companies replying.

TABLE VI

Period Between Purchase and Trade-In	*Company-Owned Fleets*	*Salesman-Owned Fleets*
1 year	5%	4.5%
2 years	55%	65.5%
3 years	40%	25.0%
other	0%	5.0%

Every company-owned car is traded within at least three years, while no salesman-owned car is reported to be older than four years, and 95% are traded at least every three years. In the case of the companies owning fleets, 65% report that the trade-in period is governed largely by the condition of the car. Before trading they consider each car's trade-in value, present state of repair, anticipated major repair and maintenance costs, and balance these factors against the price and availability of new cars. The usual policy with the rest of the companies is to trade cars automatically after a certain period of time or a certain number of miles. For example; "3 years or 50,000 miles, whichever first", and "2 years or 40,000 miles, whichever is longer" are typical comments.

With reference to salesman-owned fleets, 90% of the companies replied that there are no regulations limiting the age of salesmen's cars, although several encourage their men to trade cars at least every two years. Others expect their men to keep a good car, in good condition, and use only conservative colours and styles. The 10% who enforce limitations on the age of a salesman's car require either a two-year limit or "two years or 40,000 miles, whichever first."

Insurance Policies

The following tabulation illustrates the type of insurance carried on both company-owned and salesman-owned fleets, expressed as a percentage of total companies reporting:

TABLE VII

Type of Coverage	*Company-Owned Fleets*	*Salesman-Owned Fleets*
Public Liability	100%	69%
Property Damage	95%	69%
Fire and Theft	85%	37.5%
Collision	70%	33%
Other	30%	10%
None	0%	31%

Obviously *company-owned* fleets are covered by insurance more completely than *salesman-owned.* With regard to the latter, 69% of the companies check to determine whether salesmen carry adequate insurance,

while 31% do not check. The following methods of checking were reported: policies and renewals are inspected; insurance is placed by Head Office under a group policy with the premiums paid by the company; insurance is placed by Head Office under a group policy with the premiums paid by the salesman; the company retains a copy of the policy and renewal; a verbal check only is made.

Although 31% do not check salesmen's insurance coverage, some or all of the cars may be insured. However, it is left entirely to the salesman's own discretion and the companies neither know nor care what type or amount of insurance he carries.

On the other hand, every company-owned car is covered by some form of insurance, although one company, with a fleet of 185 cars, carries Public Liability only — $100.000.00 per car. This company's operating expenses (reported at 7.1 cents per mile) include the item, "accident allowance", indicating that they feel capable of carrying the risk themselves on everything else. By contrast, 70% of all company-owned fleets are protected by Public Liability, Property Damage, Fire and Theft, and Collision. Furthermore, 30% of all company-owned fleets carry, in addition to the above, Passenger Hazard and miscellaneous coverage.

All of the companies who operate salesman-owned fleets, and who require some sort of insurance coverage, insist on Public Liability and Property Damage. About one-half insist also on Fire and Theft and Collision, while only about one company in ten requires Passenger Hazard or miscellaneous coverage, and then they invariably pay the total insurance premiums for the salesman .

Tables VIII, IX, and X compare the amount of insurance carried on both company- and salesman-owned fleets, expressed as a percentage of the total companies reporting their figures for the three main types of insurance. To determine what percentage of the total companies carry each specific type of insurance, reference should be made again to Table VII.

PUBLIC LIABILITY — TABLE VIII

Amount	*Company-Owned Fleets*	*Salesman-Owned Fleets*
$300,000 - $500,000	5%	
100,000 - 300,000	65%	9%
50,000 - 100,000		27%
25,000 - 50,000		30%
20,000 - 40,000	15%	18%
10,000 - 20,000	5%	
5,000 - 10,000		9%
No figures given	10%	7%
Total	100%	100%

PROPERTY DAMAGE — TABLE IX

Amount	*Company-Owned Fleets*	*Salesman-Owned Fleets*
No figures given	16%	27%
$ 1,000 - $ 5,000	37%	52%
10,000 - 50,000	26%	15%
100,000 - 300,000	16%	6%
Over $300,000	5%	
Total	100%	100%

COLLISION — TABLE X

Amount	*Company-Owned Fleets*	*Salesman-Owned Fleets*
No figures given	36%	19%
$25.00 deductible	14%	12%
$50.00 deductible	21%	44%
$100.00 deductible	29%	19%
Over $100.00 deductible		6%
Total	100%	100%

Company-owned fleets are not only more broadly covered by insurance, but also in greater amounts, except in the case of collision, where 56% of the salesman-owned fleets covered by collision insurance are protected by not greater than $50.00 deductible, as opposed to 35% in the case of company-owned fleets.

In every case where cars (whether company- or salesman-owned) are covered for Fire and Theft, it is for the actual cash value of the vehicle. It is interesting to note that three company-owned fleets made up of 67, 170, and 185 cars each, are not covered by this type of insurance. Company-owned fleets, when covered by Passenger Hazard, generally carry $20,000 to $40,000 for one and two passengers respectively, as compared with $5,000 per passenger when the car is salesman-owned. In both types of fleet operations, miscellaneous coverage is for damage resulting from ice, hail, wind, falling objects, aircraft, floods, riots, etc., the car being covered for actual cash value.

There is no correlation between the size of the fleet and the type and amount of insurance carried when the cars are salesman-owned, but there is a certain marked correlation when the cars are company-owned. As might reasonably be expected the companies with the smallest fleets carry the widest coverage, and in the largest amounts. For example, those fleets covered by Passenger Hazard and miscellaneous coverage average 14 cars per fleet, ranging from 1 to 24 cars per fleet,

compared with an overall fleet average of 64 cars. These same fleets also carry all of the other types of insurance in larger than average amounts. Furthermore, of those companies carrying collision insurance, 57% operate fewer than 45 cars per fleet, and the average fleet size of those carrying $25.00 deductible is only 12 cars. A smaller fleet usually signifies a smaller company, and these presumably feel that they can't afford the risk. . The larger companies appear more willing to underwrite their own risks.

The following results were recorded in answer to the question of who pays the premiums on this insurance.

TABLE XI

Premium Payer	*Company-Owned Fleets*	*Salesman-Owned Fleets*
Company	90%	17%
Salesman		75%
Both	10%	8%
Total	100%	100%

In every case, insurance premiums are paid for by the company when the fleet is *company-owned,* but one company in ten requires its salesmen to contribute nominal amounts to cover overhead, including insurance. (In return, the salesman has practically unlimited use of the company car for pleasure driving.)

With regard to *salesman-owned* fleets, in 75% of the instances where both the company and the salesman pay the premiums, the company pays for the coverage they insist upon; e.g., Public Liability and Property Damage, while the salesman pays for whatever else he wishes to carry; e.g., Collision, Fire and Theft, etc. Occasionally the company carries a blanket policy protecting itself from lawsuits arising from accidents involving their salesmen; or the company may pay for all insurance via a group policy and require the salesman to pay a portion of the total premium. When the company pays the total insurance premium the actual remuneration to the salesman for the use of his car is very frequently below the average. Usually it is a means of making sure that the salesman carries adequate insurance; or else the company customarily pays all of the salesman's car expenses by voucher, giving him a cash allowance for depreciation only, or perhaps no cash at all. In rare instances it is a straight goodwill gesture on the part of the company.

Finally, in answer to the question, "Who pays for legal service in the event of accident if *not* the insurance company?" the following results were obtained:

Party Paying	*Company-Owned Fleets*	*Salesman-Owned Fleets*
Company	85%	10%
Salesman		73%
Both		3%
No answer	15%	14%
Total	100%	100%

Companies answering "both" indicated that it would depend upon whether the man was on business or not at the time of the accident. In the case of salesman-owned fleets, the services of the company's legal advisors are offered free of charge if assistance is given at all. The man can either accept these services or pay for his own.

Conclusion

No clear-cut conclusions may be drawn as to the proper way to control or administer salesman's automobiles and expenses. It is hoped, however, that the reader who is experiencing difficulty with the operation of his cars may find, in the results of this survey, some helpful ideas or methods which will aid him in successfully meeting his own situation.

Any Organization Can Survive Its Key Men

J. Lyone Heppner
Montreal District Manager
Confederation Life Association

How can one ensure that a business will survive its owner, partner, chief shareholder or other key personnel? Mr. Heppner has some specific solutions to a problem confronting many businessmen.

IN REVIEWING his company's operations for the previous year, Arthur Shelley, President of Shelley Pottery Corporation, pondered the reasons why money invested in his own company yielded much higher returns than the returns available under ordinary investment plans. He knew that his capital investment was $100,000. At 4% yield, this would give him $4,000 income a year. Yet his company's net earnings last year were $16,000. Where did the extra $12,000 come from? The answer was obvious. Seventy-five per cent of the profits must have come from his executive team—from himself and the other key men in his organization who made the decisions responsible for his company's success.

What would happen to his company profits if his smooth-running team of executives were weakened by the loss of one of the members? Suppose Martin Scott, the sales manager, were to die. Would a replacement be easily found? How soon would it be before he could learn the job? Or suppose Milton Bush, shop superintendent, were to move over to one of his competitors. How much would production fall off while they were searching for his successor?

Replacements are costly. A responsible executive is not reading want ads or walking the streets in search of jobs. Substantial inducements are necessary to pry him from his present position. And, even after a replacement takes over, he undoubtedly makes costly mistakes initially because of his unfamiliarity with the business.

Shelley knew that his plant and equipment were insured against loss, even though loss might never occur or might be only partial. Yet, in his view, plant and equipment were responsible for only 25% of his company's profits. Was there a way in which he could insure against a financial loss due to the death of a key man? Was there a way to help his corporation offer more attractive long range retirement plans for his key men?

Life insurance had one sensible answer. Key Man Life Insurance provides a fund, available upon the death of one of the executives, to indemnify the company against such a loss. Life insurance policies taken on the key men, with the company as the beneficiary, may be used as a special surplus credit account. Shelley was thus able to insure against any probable financial loss. At the same time the policies could be used to fund an extra, special retirement plan or as a salary continuation plan to the widow of an executive who died prematurely. Incidentally, these special arrangements also tend to reduce the possibilities of the loss of a key man because of a more attractive offer from a competitor.

Basic Problems

Two underlying questions continually concern the successful business man during the course of his working days. First, "What would happen to my business if I lost the use of my factory or equipment through fire or similar catastrophe, and how could I survive a premature loss of my partner or other key personnel?" Secondly, "How could my business live if something were to happen to me?"

The life insurance solution to these two problems is today an accomplished fact. Owing to the many diversified uses of life insurance, it is now possible for the progressive underwriter to present several different methods of solving such problems. Recommendations are usually made under one of the following headings:

i. *Key Man Insurance*
ii. *Sole Proprietor Insurance*
iii. *Partnership Insurance*
iv. *Close Corporation Insurance.*

The problem of the loss of a key man has already been demonstrated in the story of the Shelley Corporation. Let us turn now to the case of the sole proprietor.

The Sole Proprietor

The imaginary Mr. Burton, owner of a prosperous hardware store, has a problem fundamentally similar to Mr. Shelley's. Mr. Burton is 42, married with three children—two boys and a girl. He lives comfortably, owns his own home (with a mortgage) and looks forward to the day when he can retire and let the boys carry on. However, he frequently wonders: "What is going to happen to the business when I die? Is my wife capable of running it? Would the staff get along as well with my sons as they do with me? How long will it be before the boys have finished college and are able to go into the business? Will they like it? How can I leave the business to them and still give my wife complete independence and security? How am I to give my daughter her share of my estate? Supposing the business went broke, what

would my wife live on? Will my creditors be as co-operative with my family as they are with me? If I die prematurely how will my wife be able to bring up the family and still run the business?" And so on . . .

Mr. Burton eventually discussed these questions and many others with both his lawyer and a life insurance business consultant and the following project was developed:

The Plan

Mr. Burton specified: "I want the business to go to my boys. My wife must be guaranteed a minimum of $100 per week for the rest of her life, in lieu of the business, not counting any other monies that she will get from my estate at my death. When my daughter is twenty-one she is to get the first of three cash payments, the second to be made on her twenty-fifth birthday and the third when she is thirty years of age."

The Solution

Arrangements were made for life insurance policies to be taken on Mr. Burton's life by the three children. A trust company was made beneficiary in the case of the sons. The daughter's contract was covered by settlement options in accordance with the father's wishes. A will was drawn up leaving the business to the mother. At the same time a trust agreement was effected with the trust company so that the proceeds from the insurance policies were to be set up as a trust for the boys. Instructions were included in the trust that the money could be used to purchase the business.

The Result

Mr. Burton achieved: (i) Complete peace of mind insofar as the survival of the business and the independence of his wife and daughter were concerned.

(ii) A sinking fund set up for the purchase of the business by his sons when they are ready to take over and he wishes to retire.

(iii) A basis for further credit should he ever require financial assistance at a future date.

Mr. Burton could have decided that this plan was both too expensive and unlikely to succeed because of the uncertainty of the boys' choices of careers. He could just as easily have decided to ensure that his staff at the store would always be faithful and proficient by giving them the opportunity to buy him out. The solution in this case would be life insurance policies on his life taken out by the chief members of the staff. A Buy and Sell Agreement providing for the sale of the business to the chief members of the staff should Mr. Burton die prematurely, would be drawn up. Should Mr. Burton live till the retirement age of 65, the cash values of the policies would be used as a down payment by the staff for the business. In this fashion Mr. Burton could

stimulate the chief members of his staff to greater efforts, enhance his own credit rating, and guarantee a quick cash market for his business when he died—all under the same plan.

The Partnership

Let us assume that Smith and Brown have been in business together for many years. They each own fifty per cent of the business. It is prospering largely on account of the sales ability of Brown and the administrative ability of Smith. They are a well co-ordinated team and are both quite satisfied that they are capable of overcoming any problem that is likely to beset their business—as long as they both live. However, the partners have been wondering what would happen to their business in the event of the death of one of them. They have visions of forced sales, or unhappy relations between the surviving partner and the widow or executors of the estate of the deceased. If Brown were to die his family would inherit his interest in the business and then Smith would have inexperienced people as associates in the enterprise.

To avoid such an undesirable situation business continuation insurance is taken on the life of each man so as to provide cash with which the decedent's interest is purchased. A Buy and Sell Agreement is drawn up so that there is no misunderstanding as to what these two men want to have happen in the case of death.

Imagine that there is no such arrangement, and suppose that Brown died and left his interest in the business to his wife. Mrs. Brown could then say to Mr. Smith, "I am going to take my husband's place because he left his share of the business to me, AND I will expect the same share of the profits that he would get if he were alive AND I require the same salary that he drew." Or she could inform him that she wants her son, brother, relative or any other person to represent her interest and receive the same consideration. Mr. Smith would no doubt challenge such demands. Nevertheless the widow could successfully force the issue. His only alternative would be to either buy Mrs. Brown's shares at her price or sell his shares to her. In the event that they were unable to agree upon a reasonable price, the business would have to be liquidated or Mrs. Brown's wishes accepted. Under these conditions Mr. Smith would be burdened with paying a large salary to an inexperienced manager. In the majority of the cases the situation would become impossible with a resultant loss of profit.

Let us assume that, eventually, after a considerable amount of friction, Mrs. Brown agrees to allow Smith to buy her out for a cash payment of $50,000. Mr. Smith's problems now take on a new light—where is he going to find $50,000? Interest charges would be heavy if he borrowed the money—and it would still have to be paid back. The difficulty of financing such a loan and still maintaining good

credit for the business would be extremely hard—AND there is no guarantee that he could successfully negotiate the loan. It would be equally hard to find a new partner with whom Smith could work, and who would be willing or able to invest such an amount. Experience indicates that the business would have to be liquidated and Mrs. Brown paid off. The chances are that a loss would have to be taken on the full value of the business and both parties would suffer. After many years of hard work Smith would have to start all over again to establish a new business.

Assuming that Business Continuation Insurance, better known as Partnership Insurance, had been taken out, none of the foregoing would have been necessary. In general practice, each partner buys insurance on the life of the other and, if at all possible, arranges for a third party to be the beneficiary of the policies and the administrator of the Buy and Sell Agreement. This agreement incorporates all instructions as to what is to be done with their respective shares in the business in the event of the death of one of the partners. It is essential, however, that thorough and precise details be included insofar as the exact evaluation of the business is concerned. As a rule, a formula is agreed upon regarding not only the book value but also the manner of evaluating the goodwill. It very often happens that, because of the friendship of the persons concerned, too much is agreed to by mutual understanding without proper confirmation. Unfortunately, memories are short, and one of the parties may not be available at the time of consummation. The best intentions can be spoiled by a job half done. By covering any contingencies caused by the death and ensuring the survival of the business, several other benefits are also obtained:

i. The surviving partner becomes the sole owner of the business with no large cash outlay except the payment of the premiums. In most cases the partners agree upon a salary increase sufficient to pay the premiums and the added personal income taxes.

ii. The surviving partner also usually has the opportunity of purchasing the insurance policy on his life owned by the deceased's estate at the present cash surrender value. Thus he finds that his estate has doubled in value and that he has life insurance protection, taken at a much earlier time of his life to cover the added cost of his own succession duties.

iii. A special emergency fund is established during the lives of the partners to cover extraordinary credit requirements. Suppose the insurance on the respective lives of Brown and Smith totalled $100,000, that the policies were 10 years old, and an emergency arose where the business required extra credit above its ability to obtain. At that time the cash values of the policies would

represent a substantial amount which would then be available to the general purposes of the firm.

iv. Similarly, operating credit of the business is stabilized from the minute that the insurance is accepted. The existence of Business Continuation Life Insurance, assigned to the firm and thus included in financial statements to the bank and other credit organizations, tends to instil further confidence in these parties. In the past few years most credit agencies and practically all banks have been asking in their questionnaires whether or not insurance is carried on the lives of the executives and whether it is available for the benefit of the business. It is a general consensus of opinion that when a firm indicates such coverage it is looked upon more favourably for credit purposes.

v. When Brown dies the entire plant might be thrown out of order and disorganized. Smith has double work to do, plus the numerous arrangements caused by change of ownership. The credit of the firm is temporarily curtailed by creditors who wait to find out how the replacement of the personnel will be handled. Credit sources are particularly sensitive to changes in management. Their attitude is well summarized in a statement from the office of the National Association of Credit Men: "By all means, the most important element in business success is the character and ability of the man himself." Dun and Bradstreet's managing editor concurs: "Despite the presence of various safeguards under which business is now conducted, and despite the scientific study of merchandising profits, the importance of the personal element in business success is more truly evident than ever before." Insurance proceeds act as a shock absorber for the many simultaneous blows directed against the firm when an important member dies.

vi. A retirement fund is also created should both partners live to retirement age. The Buy and Sell Agreement can include a special clause providing for the cash values of the policies to be used as the basis of a retirement fund. In this instance consideration must be given to the specific ages of retirement. Thus foresight in the control of one's business guarantees liquidation during life as well as in death.

The Close Corporation

The "close" corporation has the definite advantage of its own legal existence beyond any owner's death. The problem of survival, however, in case of death of one of the chief shareholders or key men, is equally complicated and serious. In many a case the corporation has found itself involved in a struggle which resulted in a dissolution just as ruinous and sure as if it had been automatic.

The close corporation can be defined generally as a limited company in which the stock is held entirely by a few individuals who are active in the management of the business. The shares do not have to be equal, although such equal ownership interests are common. Another characteristic of the close corporation is that there is no particular ready market for a quick sale or profit.

Let Mr. X, Mr. Y and Mr. Z be partners in a corporation capitalized at $80,000. One hundred and sixty shares have been issued. Mr. X owns 80, Mr. Y owns 50 and Mr. Z owns 30 shares. The money has been used to purchase the necessary equipment, space and organization to incorporate their three individual businesses into the one limited company.

Suppose that a life insurance underwriter has presented a proposition that in the event of the death of one of the shareholders the other partners are to buy the deceased's shares and carry on the business. Otherwise a new person will appear to take over the interest of the decedent. If X dies he will no doubt leave his shares to Mrs. X and daughter Miss X. They in turn will wish either to come into the business themselves or have someone represent them in order to protect their interests. This situation could cause Messrs. Y and Z much embarrassment and considerable difficulty in the management of the business. X's representatives could actually prevent any action by the company which they think might injure their investment. Because of inexperience, a clash in temperament or a disagreement in policy, Mrs. X might even go so far as to force her ideas upon the company to such an extent that the corporation might eventually disband and be compelled to go out of business.

The same situation could hold true in the case of either Mr. Y or Mr. Z. Minority stockholders may bring suit against the corporation for performing an act which it is felt is detrimental to the minority's interests. The case of Bates Street Shirt Co. vs. Waite (as detailed in the University of Illinois Bulletin, 1950) amply illustrates the point:

> "The widow of a minority stockholder in this company first brought suit seeking to compel the corporation either to purchase her shares or to pay dividends on them. When this suit was dismissed, she brought another action charging fraud and mismanagement, apparently hoping that the company would buy her out rather than go through with the court fight. The results were manifold. The court itself observed that 'the allegations contained in both complaints were widely published, as a result of which both these defendants (the majority stockholders and the corporation) were subjected to unpleasant criticism; applications for loans were more closely scrutinized than had been ordinarily the case; and those connected with the company believed with good reason that the pendency of the litigation was injurious to its business.' The

> case was settled, finally, by purchase of the widow's stock. But then the preferred stockholders brought a suit, in which they claimed that the use of the company's funds for the purchase was injurious to their position. Although the courts upheld the expenditure, the cost of this stock and the costs of three court fights produced a blow from which it took the company years to recover."

The same University of Illinois Bulletin quotes the case of an Illinois utility company. The case is not relative to Canadian corporation law since the by-laws of the company provided that stock should be offered back to the corporation at the death of any owner. However, the instance illustrates what can and does happen at the death of a shareholder.

> "In spite of the above stated by-law, when one minority holder died his executor distributed the shares among his seven heirs, and the corporation at that time was not in a strong enough financial position to finance a court fight in order to force the heirs to sell the stock. Some years later, however, it became necessary to reorganize and to alter the capital structure of the corporation. To insure that the proceedings would not be halted in mid-progress by minority action, the officers set out to buy the outstanding shares. Company representatives travelled to four states to find the heirs, and with each purchase the price went up. Finally only two of the seven owners were left, both living in Texas. The price of bringing in these last small holdings turned out to be three trips to that state and a purchase price somewhat more than four times the book value of the shares. No dividends had ever been paid on this stock, nor was it traded upon in any exchange; in effect, its value to the minority owners was negligible. But just as soon as each one learned that the corporation wanted to buy, he or she decided that there must be unsuspected value hidden away in the hitherto almost worthless paper, and that now was the time to make up for all the lack of income in the past."

Numerous cases are recorded of widow's husbands or sons or sons-in-law who have entered the business and run it into receivership. Often the shares are sold to an outside party who in turn causes discord and a resultant loss of profit and a forced sale; or to a competitor who purchases the shares with a definite intention of destroying such competition.

Let us assume, therefore, that the underwriter has persuaded the members of the X.Y.Z. Company to enter into a Stock Control Plan and that they have agreed to finance the plan by life insurance. Policies are taken out on the lives of each individual for an amount equal to the present value of their shares and a trust company is named beneficiary of the policies as well as administrator of the plan. Regular intervals have been alloted for a revision of the plan so as to keep it up to date. As the company grows, provision must be made for a re-evaluation of the assets; similarly times and personalities both change, out-

dating the agreement. In order to complete the Stock Control Plan the partners also agreed to deposit their shares of the company with the trust company, so as to facilitate any action and to permit the trust company to administer the plan without any interference or influence.

Since X owned $40,000 worth of the business, Y owned $25,000, and Z owned $15,000, the following life insurance policies were purchased:

X & Y each took out $7,500 on the life of Z.
X & Z each took out $12,500 on the life of Y.
Y & Z each took out $20,000 on the life of X.

Shortly after the plan had been consummated and the life insurance policies were placed, Mr. X died and the life insurance company paid $40,000 to the trustee. In accordance with the plan this money was immediately transmitted to the estate and Mr. X's shares, which had already been endorsed, were distributed to Y and Z according to instructions. The result was that Y and Z owned the corporation in the same ratio as their original investments and the executors of Mr. X's estate had cash to distribute the estate according to the will.

The partners could have agreed that on the death of any one of them the life insurance policies could have been purchased in such a fashion that the remaining two became equal shareholders. In this case the distribution of life insurance would be as follows:

Y takes out $15,000 on the life of X.
Y takes out $15,000 on the life of Z.
Z takes out $25,000 on the life of X.
Z takes out $25,000 on the life of Y.

Another variation is often used where just enough insurance is taken out on the lives of the partners to cover a substantial down payment for the purchase of the deceased's stock. The balance is to be paid over a period of years. In this instance special mention must be made in the Stock Control Plan, and detailed instruction included as to the exact manner of payment and control of the remaining stock which has not yet been purchased.

In most cases the amount of insurance is contingent upon the cost of the insurance premiums. The usual manner of payment is a special yearly bonus paid by the company to the partners in relation to their shares in the business. This bonus should be sufficient to cover the life insurance premiums and the extra income tax charges caused by the increase to their incomes. Because of a difference in ages the bonus is usually based upon the highest premium, and the other partners receive a pro rata amount to pay the premiums and use the balance as they so desire. It is to be remembered that at the time of death the existing members of the company will require cash to purchase the life insurance policies held by the deceased's estate on their respective lives.

An arrangement of this nature should also be included in the Stock Control Plan so that there will be no misunderstandings. The evaluation is almost always that of the present cash surrender value of the policies at the time of death.

Very often the difference of ages is so vast as to cause an impossible problem for the younger man. Suppose that A and B are partners in a small business. The partnership is now worth $32,000.00.

A is 32 years of age and owns one quarter interest.

B is 54 years of age and owns a three quarter interest.

Mr. B is anxious to enter into a Stock Control Plan and wishes to create an emergency fund through life insurance. It is a financial impossibility at the present time for either the company or A to pay the premiums for total coverage on B's life. Two alternatives are available:

1. A can insure B for $8,000.
   B can insure A for $8,000.
   When B dies A is now in a position to make a down payment of $8,000 for B's shares and pay the balance over a period of time. As time goes on A hopes that either he or the company will make more money and thus be able eventually to finance insurance on his partner's life for the full $24,000.00.
2. B realizes that in a short while he might become uninsurable. He therefore loans A sufficient money each year to pay the premiums on $24,000 worth of insurance on B's life, and receives a collateral assignment of the policy from A so that in the case of the latter's death the insurance proceeds will go to B. Should this happen, A's estate would receive the full value of his shares from B and B would not only get the money he loaned back but also make a substantial gain. On the other hand, should B die, the agreement would provide for A to purchase B's shares with the proceeds of the insurance policy, and also pay back the loans made to him.

It is obvious that there are myriad situations that can arise. Each one has its own complications. Experience has shown that as long as there is full accord between the partners and innate desire actually to do something about the situation, some compromise can be effected. In the above cases, as with any other type of business, the important factor is proper interpretation and completion of the *written agreement* and some manner of creating the *emergency fund* to carry out the agreement.

Creation of the Emergency Fund

The argument for the use of life insurance for the creation of the emergency fund is based on the best choice of three alternatives:

1. *By Loan*
   There is the possibility that the personal credit of all members of the firm is exceptionally good. The fact remains, however, that there is no guarantee that their credit will be just as good ten or fifteen years from now, when an associate is likely to pass away. It may happen that at the exact time death occurs business conditions are not too good. Perhaps the money which can be obtained through loans is going to be or has just been used for other investments. On top of this the loan requires interest payments and must eventually be paid back.

2. *By a Sinking Fund*
   In many cases a special Business Continuation Sinking Fund is set up for the purpose of purchasing the shares of a deceased partner. In the earlier years of the sinking fund relatively little is saved. There is no guarantee that the death may not occur at just that time. Money left dormant is not economical, the temptation to use such reserves is immense, and the eventual results could easily be catastrophic to the survival of the business.

3. *By Life Insurance*
   Since the problem is one of creating an emergency fund it is reasonable to assume that the fund will be required when a real emergency arises. The only time that such a situation will occur is when a member of the firm dies. Since life insurance policies automatically mature upon the death of the insured, it is submitted that the life insurance plan is preferable to any other method of creating the required emergency fund.
   The numerous extra benefits detailed below are also provided by life insurance and thus give this solution manifold reasons for serious consideration.
      1. It replaces the loss of a valuable life.
      2. It retires the decedent's interest.
      3. It allows the survivor to continue.
      4. It provides an emergency fund.
      5. It acts as a shock absorber.
      6. It stabilizes credit.
      7. It retires individuals.

The surviving members of the company, over and above all the other problems of carrying on a business without a partner, now find that their personal estates have overnight increased substantially in value. Their natural desire to retain as much as possible of this additional wealth for their estate when they finally die becomes a further consideration. The succession duty question is magnified. It is here that the reci-

procal protection portion of the agreement becomes of even greater importance. The deceased's estate also owns insurance policies taken on their lives when they were younger and the premiums were cheaper. By buying these policies from the deceased partner's estate at the present cash surrender value they automatically create a further emergency fund to cover themselves for a similar business catastrophe. In this manner arrangements are also made for a cash fund to be available to their estate for its liquidation at their deaths.

Conclusion

It has been the intention of this article to bring to mind some of the problems and some of the answers to making a business survive its management. All the recommendations presented are on the premise that there is some income available to ensure such a survival. The detailed mechanics of the solution, although not complicated, usually require specific study. It is therefore suggested that further information be obtained from a lawyer, a trust company or a life insurance underwriter.

Should Businessmen Utilize Theory in Pricing?

Douglas H. MacAllan

Mr. MacAllan points out the fallacies in the "cost plus" approach to pricing and suggests that generally lower price policies, based on economic theory, can prove both profitable to the businessman and beneficial to society.

AS A RESULT of intermittent reading, observation, and thinking about pricing policies over the past year or two, it seems apparent to the writer that a great number of business firms base the majority of pricing decisions on something other than generally accepted economic principles.

In an attempt to lend logical support to the above conclusion, this article will proceed to: first, very briefly, consider why an examination of prices and price policies is important; second, venture some criticisms which seem to be applicable to present pricing methods; third, summarize some aspects of economic price theory, and finally, suggest the possibility that a greater recognition of the part played by demand, and particularly the principle of elasticity of demand may well be rewarding when basic price policies are considered.

Importance of Correct Pricing Policies

Why are prices and correct pricing policies important to the individual, to the firm, and to society? The answer is so much a part of everyday experience that its very obviousness apparently causes it to be overlooked or taken for granted. In our society almost everything is bought or sold. Everyone of us is affected every day by the working of the price system. Our income comes to us in the form of money as a price for whatever productive resource we contribute. The value of that income is changed by every change in the price of the multitude of things that we buy. Prices ration consumer goods, although at the same time they allow us complete freedom to pick and choose within the limits set by our money income.

On the other hand, our willingness as consumers to pay for certain goods determines the direction which production will take. The success or failure of the individual firm will depend in the long run on whether or not the price which it receives for its product will cover costs of production. This does not mean that prices are governed or should be governed by costs of production. It does mean, however, that once a price has been set by the market or by the firm, if that market or that firm is in a position to influence price, the quantity demanded or taken

at that price must yield a return sufficiently large to cover the costs of producing the goods.

It is this necessity of covering the costs of production which appears to be behind the majority of pricing methods and policies used by business to-day. It is a matter of common observation that the majority of retailers take the cost figure of an article and add a standard markup to cover operating expenses and profit. Wholesalers in general operate on the same "cost plus" principle. Granted there are quantity and other discounts; the basic approach is "cost plus." Manufacturers too are becoming imbued with a "cost plus" approach. And it is probably at this level, particularly in view of the existing resale price maintenance practices, that the problem can best be attacked. A correct approach to pricing by manufacturers, even if standard markup procedures were followed by dealers, would do much to eliminate faulty pricing decisions.

This "cost plus" approach by manufacturers would seem to be particularly entrenched in view of the number of current articles which, while paying lip service to market conditions, in essence advocate cost accounting as to the solution to pricing problems. Unquestionably "cost plus" is an easy method of computing a selling price. Undoubtedly with a seller's market existing for the past few years it has enabled firms to operate profitably. But is it the answer to pricing policy? Has it allowed maximum sales and profits to be made? Does it create pricing policies which best serve the interests of our society? Specifically what is wrong with the cost plus approach?

Fallacies in the Cost Plus Principle

It is not the intention of this article to deny that in the long run price must cover costs. There is equally no intention of denying the value of a knowledge of costs, particularly as an aid in comparing alternative price-volume combinations, etc. But there are a number of obvious fallacies in a cost plus approach to pricing. First of all, it totally ignores demand. What people will pay for a product does not of necessity bear any relationship to the costs incurred by the manufacturer. Secondly, it does not take into consideration the effects of competition. Substitute products as consumer alternatives are ignored. The possible reactions of competitors now in the field, and the effects on the planning of potential competitors are not considered by a strictly cost plus approach. In the third place, cost plus involves a fallacious type of reasoning, since cost depends on volume, but sales volume largely depends on the price charged.

Some other approaches to pricing are equally subject to the above criticisms. Price policies or price changes designed to stabilize the break-even point or stabilize aggregate profits once again approach the problem from *inside the firm.* In addition, they are subject to the criticism that they are extremely complex and difficult to obtain.

The flaws inherent in an internal or cost approach to pricing have been demonstrated—it is hoped convincingly. Let us turn now to a discussion of the external or market approach. Here there are two aspects or facets, albeit closely related. The first of these, the relationship of the basic price policy to the general economic welfare, is completely ignored by any cost method of pricing. The second aspect should be the same for any method of price determination in that it concerns the effect of the policy on the individual firm, its profits, and its competitive position.

Relationship of Price to Demand and Supply

A market or external approach to pricing necessarily implies a closer look at the price theories of the economists. In general terms everyone recognizes and accepts that prices are determined by demand and supply. There are, however, innumerable qualifications to this general statement as the approaches to pricing discussed above have indicated. We should, therefore, in order to prepare the ground for a discussion of administered prices, briefly sketch what we mean when we say prices are determined by demand and supply.

"Individual demand is the amount of any given good an individual stands ready to buy, at a particular price, during a given time, and at a given place."[1] The two essentials of the demand are desire and ability to pay. We may, therefore, draw up an individual demand schedule based on the volume of a good which the individual will buy at each price. By combining all the individual demand schedules a market or collective demand schedule may be derived.

As with demand, supply invariably implies a relationship between amount and price. Supply is therefore defined as, "the amount one seller or group of sellers stands ready to offer during a given time, in a given market, at a given price."[2] Once again a collective supply schedule may be derived from the supply schedule of individuals. Now the tendency will be for price to settle at the point where the two schedules intersect. This is the normal price. That is the point where all buyers will find sellers and all sellers will find buyers.

An analysis of this kind is based on a number of assumptions. First of all it assumes that conditions of pure competition exist and that the individual producer cannot affect the price. It is as well a long run concept based on the assumption that producers will expand output until profits on the last unit of production are negligible. In the same way it assumes that buyers will continue to purchase until the satisfaction from the last purchase approaches zero.

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[1]F. B. Garver and A. H. Hansen, *Principles of Economics.*

[2]Ibid.

Market price is recognized as a short run concept. For example, if supply is decreased sharply, the market price will immediately become much higher than costs of production. This, however, is a temporary situation, and the normal price closely approximates the costs of production.

It should be apparent, even from a casual glance at our economy, that those conditions necessary for pure competition: (a) a large number of buyers and sellers, (b) identical products, (c) close contact of buyers and sellers, (d) no discrimination, do not have widespread existence.

Now let us look briefly at the other extreme, a monopoly price. Since we are told that price will depend on the interaction of demand and supply, the monopolist is in a position of advantage solely because he can limit at will the quantity of the goods produced and offered for sale. He will try, therefore, to set a price which will maximize his net return, limiting production to the quantity which will be sold at that price.

It is clear that this situation does not exist any oftener, if as often, as relatively pure competition. The important condition to examine, therefore, is that which lies somewhere between pure competition and pure monopoly and is typical of our economy to-day. The pure competition of the classical economists is altered by product differentiation, trade practices, unequal knowledge on the part of buyers and sellers, etc. This is the situation where the individual producer has some control (within the limites of a substitute product, or the entry of new producers into the field, etc.) over the price.

We should recognize that the price that can be charged still depends essentially on the willingness and ability of consumers to pay. However, given a particular state of willingness and ability, the individual producer by his decisions can to some degree replace the market-place as the regulator of prices and of economic activity insofar as his particular part of the business world is concerned.

Since this is so, how does the pricing executive who is responsible for these administered prices reach a decision? What are the general considerations and economic principles which he, as a marketing executive, should have in mind when determining broad, basic pricing policies?

Relationship of Demand Elasticity to Lower Prices

We have seen from cost plus and other methods of pricing, that all too often his concern is almost entirely with the supply side of the picture. It would appear that a closer examination of the economists' conception of demand and demand elasticity might easily prove profitable. As we have said, the demand curve for a product is the reflection of the combined attitudes or states of mind of a great number of individuals—individuals whose desires are backed up with effective purchasing power.

Any increase in the volume of sales can therefore only be accomplished by changing the states of mind of these individuals (i.e., shifting the position of the entire curve so that at each price more will be demanded) or by changing their effective purchasing power (which might be accomplished by a lower price, so that more will be consumed without any change in tastes). Increased sales could also be accomplished by any combination of these two (lower prices and a shift of the entire demand curve).

Most firms are unquestionably doing something about our first proposition (changing the position of the curve). Many of our marketing functions — personal selling, advertising, etc. — are designed to change the attitudes of consumers to the firm's product and bring about a positive shift in demand.

However, insofar as a basic price change in order to provide increased sales is concerned, we seem to see few signs of activity. It is in this area that, as soon as lower prices are mentioned, we run headlong into the arguments that prices have to be as high as the traffic will bear; profits have to be ensured, otherwise business will slow down; etc., etc., *ad infinitum.* Unquestionably, periods of high prices have been periods of high profits. A glance at the newspaper or the annual reports of many companies will verify that to-day is just such a period. But high prices do not of necessity mean high profits, and perhaps there are other factors which are just as conducive to profits. One of the more important of these may be increased volume—where the volume is achieved by *lowering the price.* The growth and increased profitability of such industries as aluminum and automobiles should be positive proof of the effectiveness of lower prices.

Profit Potentialities of Demand Elasticity

Elasticity of demand, on which increased profits of this type depend, is a phrase which has been bandied about sufficiently that we all have some concept of its meaning. But how many businessmen have actually considered the potentialities of demand elasticity as a profit maker? It seems to the writer that they are tremendous.

Alfred Marshall was the first to introduce the phrase 'elasticity of demand' and he defined it as follows, "The elasticity of demand in a market is great or small, according as the amount demanded increases much or little for a given fall in price."[3] It is now customary to distinguish five cases of elasticity ranging from the perfectly elastic to the perfectly inelastic. Obviously perfect elasticity is a theoretical concept, but the concept of a relatively elastic demand is very real. A product which has this type of demand is one where a given change in price will produce a more than proportionate change in quantity demanded, with a resulting increased total revenue.

[3]Alfred Marshall, *Principles of Economics.*

The Elasticity Concept Applied to Price Policy

Can this concept of increased volume and resulting higher returns be applied to the individual business situation? If we expect a mathematical calculation of the coefficient of elasticity for a particular industry or firm, the answer is undoubtedly, no. Even if we assumed that it was mathematically possible to derive a demand curve and establish the coefficient of elasticity, the very fact that it would be based on a situation where all determinants of the buyers' actions, except price, were held constant, would make it useless for practical purposes.

However, the individual firm or pricing executive, if he recognizes the general principle of elasticity and the possibility of its applicability, can make a number of relatively simple studies based on actual experience which can be both practical and useful.

Within every business, and particularly within the larger firms, which are likely to be more concerned with administered prices, there is an accumulation of sales data which can be used to examine past pricing practices and to formulate price policy. Accordingly, it should be feasible to make relatively continuous experiments with price-volume relationships of various product lines, and of the articles, sizes and qualities within those lines.

It is not reasonable to attempt to find a coefficient of elasticity for a company's total output or total market. It does seem reasonable, however, to examine closely the price-volume relationship of a particular commodity within a particular market area. And if this area is carefully chosen, it is reasonable to suppose that the relationship will in a general way apply to the total market.

Some indication of pricing policy for a new product may possibly be obtained through simple correlation studies of past volume-price relationships in closely related fields. It seems needless to point out that this can be of limited value only, because of product differentiation and changing market conditions.

It is important to point out, however, that the demand curve for the product probably does not approximate the theoretical smooth curve of economic theory. It is much more likely to have an irregular appearance, with the result that modest reductions may not produce relatively larger volume increases. This should not, however, be taken as proof that the product does not have positive elasticity. It may simply mean that the absorption ability of the particular market in which sales are now being made has reached its peak. A different market group may exist, which can be reached by a further larger price reduction, which will tremendously increase sales. Perhaps a different price-quality relationship is indicated.

At the start of the discussion of an external approach to pricing,

we mentioned that through promotional activities sellers are always attempting to bring about a change in the actual position of the demand curve in order to increase volume. Perhaps, now that we have examined the role of decreased price on a particular demand curve, we should examine what effect a basically lower price would have upon the position of that curve. To recapitulate, we first of all looked at a demand curve for a particular product in a particular market and considered the possibility that the curve was elastic with greater net returns resulting from a decreased price. Let us now look at the possibility that a lower price creates an entirely new market with a resultant shift of the entire curve. This phenomenon has been called "income demand elasticity" to differentiate it from price elasticity of demand.

Relationship of Income to Effective Demand

There is a general awareness that economists have classified, in a general way, the changes which occur in the proportion of family income spent on the major classes of expenditures (food, clothing, housing, etc.) as the level of income rises or falls. It would appear that an even broader statistical study of what is taken from the market, classified according to income level of the buyers, would be extremely useful to sellers of differentiated consumer products. It would soon be abundantly clear that what is lacking in the lower income levels is not demand, but effective demand—that is, demand backed up by purchasing power. What the pricing executive in an age of mass production should want to know is how rapidly the number of buyers and the individual amounts taken by present buyers expand with a lowering of price.

It is obvious that in general rich people have a relatively inelastic demand for all but extreme luxuries and that poor people have relatively elastic demands for all but absolute necessities. Likewise, it is an absolute fact that there are far more people in the lower income brackets than there are in the high income groups. A glance at the following table, abbreviated from more complete information in the 1950 Canada Year Book, should be sufficient to give some idea of this distribution.

INDIVIDUAL INCOME - TAX STATISTICS
TAXATION YEAR 1947

Income Class	*Tax Payers*	*Total Income Declared* $'000
under $ 1,000	213,290	187,444
$ 1,000 and under $ 2,000	1,025,270	1,577,658
$ 2,000 and under $ 3,000	773,780	1,869,220
$ 3,000 and under $ 5,000	249,800	923,983
$ 5,000 and under $10,000	76,190	513,550
$10,000 and under $25,000	24,567	351,170
$25,000 or over	3,559	157,933

Value of Experiments with Price-Volume Relationships

Since we have a general condition such as this, would it not be extremely worthwhile to examine closely how the individual product manufactured fits into this broad condition? At what point in the pricing picture can the manufacturer of semi-luxuries, for example, expect middle class families to be interested in two cars or extra radios, etc.? Where does he enter the stratum of purchase by low income groups which previously have gone without? Then how does this increased volume and revenue compare with unit manufacturing and distributing costs? What economies can be effected through larger volume production and sales? What are the possibilities of a change in the price-quality relationship, etc.? These are the questions which cost accounting should answer after the price-volume relationship has been established from a study of the market.

If income-demand studies are to be useful, however, we must first of all have a broad general picture of the actual apportionment of individual and family expenditures among various goods and services identified by size and quality. This could probably be done effectively with a relatively small but carefully constructed sample. Once this general picture was established, the individual seller could compare his situation with the general picture and attempt to solve his particular problems by spot experimental studies. These experiments over a period of time should give some very real answers to questions of basic price policies.

Benefits of Basically Lower Price Policies

So far we have been talking about price-volume relationships as though they existed in a vacuum. Obviously they do not. Volume is not always achieved by lowering price. It is quite apparent that there are inelastic goods which would not be taken in substantially greater quantities no matter what the price. If the use of a good is dependent upon the purchase of another commodity, it is immediately clear that an increased demand is dependent upon the increased use of the second commodity and not upon a lower price.

There is as well for some manufacturers and sellers the problem of trading down. Actually a decision in basic merchandising policy, it is not truly a problem for a great majority of sellers in a mass production era. This argument is particularly applicable if the view is taken that it is the job of business to provide for as many people as possible as large a quantity of goods as possible. Undoubtedly the criticism can be applied that prices cannot be reduced without reducing profits. A strong rebuttal has already been found in the greater volume argument with its resulting economies of manufacturing. The answer can also be given, however, that if we accept the basic philosophy of lower prices, in order to increase the material well being of a large segment of our economy,

ingenuity and inventiveness will find a way to reduce the costs. It has been done in the past by some of the most successful businessmen and it can be done again. Certainly cost plus would seem to lead to the opposite position of higher prices and a production restricted to filling the demand of only those with sufficient purchasing power to back up that demand.

Summary

Pricing policies are of the greatest concern to all individuals, firms and society as a whole. Cost plus or other internal methods of pricing are concerned only with the supply side of what should be a demand and supply picture. A closer look at demand and particularly the concepts of price and income demand elasticity could easily prove profitable to the individual businessman. This examination may best be achieved through controlled experiments with the price-volume relationships. Basically lower price policies, where an elastic demand exists, are obviously to the benefit of society and the economy as a whole.